



**ANNUAL  
REPORT  
1987**

**Polysar**

Energy & Chemical Corporation

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The Polymer division has built a pilot plant in Sarnia for TORNAC, a new type of nitrile rubber with heat and oil resistant properties that are in increasing demand, particularly by the auto sector.



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# Polysar

Energy & Chemical Corporation

444 Yonge Street, Suite 200  
Toronto, Ontario M5B 2H4

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April 20, 1988

Dear Shareholder:

We are pleased to invite you to attend the forthcoming Annual Meeting of Shareholders to be held on May 25, 1988 in Toronto. At the meeting, in addition to the usual matters to be considered, we will present a progress report on the achievements of the Corporation in creating value for you, our shareholders.

The Corporation has gone through dramatic changes over the last sixteen months and a solid foundation has now been laid for continued progress beyond the remarkable results already achieved.

## Strategic Refocus Completed

In 1987, the Corporation aggressively implemented its new strategic plan to move away from the structure of a widely diversified conglomerate and to refocus its activities on the petrochemical and petroleum industries. Major divestitures of non-strategic assets contributed to a reduction of coupon-bearing capital by more than \$1.4 billion, to a substantial reduction of financing and administrative costs and to the elimination of several businesses operating at a loss.

The name "Polysar Energy & Chemical Corporation" was adopted in late 1987 to reflect the new business profile and the private sector nature of the Corporation.

## Record Operating Results

The benefits of the strategic plan as reflected by the asset divestiture program, combined with favourable markets for Polysar's petrochemical products, led to a major improvement of its operating results in 1987. Consolidated income from operations totalled \$119.3 million, up sharply from a restated loss of \$236.7 million in 1986. On a per share basis, the 1987 income from operations was \$1.33 per share (\$1.26 fully diluted) compared with a loss of \$7.73 per share in 1986.

New records were set in the first quarter of 1988. Consolidated net income was \$82.2 million compared to \$13.3 million in the first quarter of 1987. On a per share basis, income was \$1.16 per share (\$0.93 fully diluted) compared with break-even net income in 1987.

## Innovative Financial Restructuring Plan

For several months, the Corporation considered a number of alternative plans to enhance shareholders' values, since in the opinion of the board of directors the underlying value of the assets of the Corporation and its promising operating outlook were not being recognized by the stock market.

Early in 1988, the board of directors approved a financial Restructuring Plan which, when completed, will result in the distribution to common shareholders of cash and securities with an estimated aggregate value of \$617 million or \$9.60 per common share.

While the Restructuring Plan will result initially in the creation of some new coupon-bearing capital obligations, the plan is financially prudent, particularly in view of the strong operating performance of the Corporation.

## Outstanding Stock Market Performance

Between January 1, 1987 and December 31, 1987, the common share price of Polysar rose 83.0% from \$6.00 to \$11.00 as compared to a 3.0% increase for The Toronto Stock Exchange 300 Composite Index



over the same period. The market price of the Corporation's common shares continued to rise in 1988 as the Restructuring Plan was announced and the market gained a better appreciation of the Corporation's outstanding operating results. Based on the closing price of the common shares on April 19, 1988 the aggregate value of a common share and the First Distribution has risen to \$24.23 per share. Your board of directors is pleased with the success of the financial Restructuring Plan.

### **Further Initiatives to Provide Maximum Shareholder Value**

- The board of directors believes that since the federal government has sold its remaining shares in the Corporation, shareholders should have complete latitude to adopt whatever articles and by-laws they wish, as is the case for almost all other public companies. In this respect the board of directors believes that the current share ownership restrictions stipulated in the CDC Reorganization Act are detrimental to the realization of maximum share value in the marketplace. Therefore, the board of directors has instructed management to approach government and discuss ways in which the Corporation's charter could be changed to give the shareholders the right to amend the articles of the Corporation. If and when this occurs, the board of directors will propose to the shareholders the appropriate amendments to the Corporation's charter regarding the share ownership restrictions. These amendments will be designed to ensure that all shareholders have the opportunity to realize maximum value either in the normal course of operations or in a takeover situation and by protecting shareholders against self-dealing by dominant shareholders.

- If the share ownership restrictions can be amended or if otherwise appropriate, the Corporation intends to seek a listing of its common shares in the United States. As its petrochemical operations presently dominate the operating performance of the Corporation, there is no other Canadian company in the industry against which to evaluate Polysar. A U.S. listing will expose Polysar to a wider range of analysts and institutions knowledgeable in the petrochemical industry and should help to recognize its value by reference to a broad group of comparable companies.

- While the Corporation remains subject to the current share ownership restrictions, any person can propose an acquisition of all of the Corporation's assets thus effectively acquiring control of the Corporation. Management is prepared to discuss with any interested party the structuring of a transaction involving the assets of the Corporation. Your board is prepared to submit to the shareholders any proposal which it considers to be in the best interests of the Corporation and its shareholders. Any proposal will also be analysed in light of its effect on employees of the Corporation and its subsidiaries.

### **NOVA's Attempts to Gain Control of the Corporation**

In October 1987, Nova Corporation of Alberta, Polysar's major competitor in the production of ethylene in Canada, also recognized that the stock market was seriously under-valuing the Corporation. Sensing an opportunity to purchase a major competitor cheaply, Nova began to purchase shares of the Corporation in October 1987 at prices ranging from \$9.15 to \$14.25 without giving any notice of its activities. Nova's acquisition process recommenced at the end of January 1988 when it made an unsolicited take-over bid to increase its holding in Polysar to about 25% (the maximum legally permitted), at a price of \$14.00 per share. This offer was rejected by your board of directors as grossly inadequate and Nova eventually purchased the shares it sought at \$16.00 per share, a price your board still considered to be inadequate.

At the end of March 1988, Nova, in furtherance of its objective of acquiring Polysar's petrochemical operations, made an offer to the Corporation to acquire all of its assets at a price of \$22.50, which was equivalent to only \$13.04 per share after giving effect to the estimated value of both distributions under the Restructuring Plan. On April 7, 1988 your board, after due consideration, rejected Nova's proposal because, in their view, it did not adequately reflect the underlying value of the Corporation in light of its current strong operating performance and its attractive prospects for the future. In view of current trading prices of the First Distribution and the Corporation's common shares, this proposal is less than shareholders can now realize by simply selling in the market. Further, the Nova price incorporates no premium over current market values, as would be normal in the case of an acquisition of control.



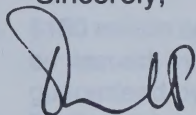
After Nova acquired its 25% interest in the Corporation, it requested representation on the Corporation's board of directors. This has been rejected as inappropriate on the basis that Nova is, both directly and indirectly, a competitor of Polysar Limited and Canterra Energy Ltd., the two operating subsidiaries of your Corporation. Further, the board believes that because of Nova's stated interest in purchasing the Corporation's assets at the lowest possible price, Nova's agenda and interests are different from and in conflict with those of the Corporation and its other shareholders. Accordingly, it is the view of your board that it would not be in the best interests of the Corporation that Nova be represented on your board of directors. Presently, 15 of the 17 members of your board of directors (all of whom are nominated for re-election) are independent of management.

### Shareholders' Support

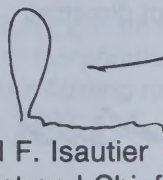
The accompanying Notice of Meeting and Management Proxy Circular outline the actions to be taken by shareholders at the forthcoming Annual Meeting. The management of the Corporation and its board of directors seek your support for the election of those nominated as directors as described in the Management Proxy Circular. We are confident that you will agree with us that the outstanding operating results of the Corporation together with the success of the Restructuring Plan and the rejection of three offers by Nova, all of which have improved the value ascribed to the Corporation by the marketplace, justify your continued support. We are committed to take the steps necessary in the future to assure that the Corporation is pursuing the best strategy to improve operating results to enhance value for all shareholders.

We sincerely hope that you will be able to attend this meeting. However, if you do not plan to be present, we would appreciate your taking a few minutes now to carefully complete, sign and return your proxy which is being solicited by management, so that your shares can be voted at the meeting in accordance with your instructions. We respectfully request that you do not return any proxy forms solicited by anyone else. Regardless of the number of shares you own, your vote is important to us.

Sincerely,



Pierre Côté  
Chairman of the Board



Bernard F. Isautier  
President and Chief Executive Officer

**YOUR VOTE IS VERY IMPORTANT. THE BOARD OF DIRECTORS URGE YOU TO SIGN, DATE AND RETURN TODAY THE ENCLOSED PROXY IN THE ENCLOSED POSTAGE PREPAID ENVELOPE.**

**IF YOUR SHARES ARE HELD IN THE NAME OF A BROKER OR NOMINEE, YOU MUST PROVIDE VOTING INSTRUCTIONS TO THE BROKER OR NOMINEE FOR YOUR SHARES TO BE REPRESENTED AT THE MEETING.**

**FOR ASSISTANCE OR FURTHER INFORMATION, PLEASE CALL COLLECT CLAUDE MARCHAND, CORPORATE SECRETARY, AT (416) 598-7300.**



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Energy & Chemical Corporation

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## **NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

The Annual Meeting of Shareholders of Polysar Energy & Chemical Corporation will be held in the Toronto 1 Ballroom of the Hilton International Toronto Hotel, 145 Richmond Street West, Toronto, Ontario, on May 25, 1988, at 10:00 in the morning, for the purposes of:

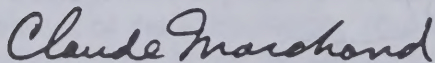
1. receiving the report of the directors, the financial statements for 1987 and the report of the auditors;
2. electing directors;
3. appointing auditors;
4. transacting such other business as may properly be brought before the meeting.

**Your vote is important regardless of the number of shares you own. Shareholders who are unable to attend the Meeting in person are asked to fill in, date, sign and return the enclosed form of proxy in the postpaid envelope provided for that purpose.**

Proxies to be used at the Meeting must be deposited either with the Corporation at the registered office in Toronto at any time up to 5:00 p.m. on May 24, 1988 (or the last business day preceding any adjournment of the Meeting) or with the Chairman of the Meeting prior to the commencement of the Meeting on the day of the Meeting or the day of the adjournment.

Holders of 1983 senior preferred shares are welcome to attend the Meeting but are not entitled to vote.

By order of the board of directors



Claude R. Marchand,  
Senior Vice President and Secretary

Toronto, April 20, 1988.



## MANAGEMENT PROXY CIRCULAR

The board of directors and management of Polysar Energy & Chemical Corporation ("the Corporation") are soliciting proxies to be used at the Annual Meeting of Shareholders to be held at the time and place and for the purposes set out in the accompanying Notice of Annual Meeting.

The Corporation will provide to any person or company, upon request to its Corporate Secretary, a copy of

- (i) its latest annual information form, together with one copy of any document, or pertinent pages of any document, incorporated therein by reference, filed with the Director of the Ontario Securities Commission under the Prompt Offering Qualification System;
- (ii) its comparative financial statements filed under the Securities Act (Ontario) for 1987, together with the report of its auditor thereon, contained in its annual report;
- (iii) this circular.

### THE BOARD'S ACTIONS TO MAXIMIZE SHAREHOLDER VALUE

During the past months the board of directors, together with management of the Corporation and its financial advisors, have been actively examining a number of plans to maximize shareholder value. At meetings in February, 1988 your board of directors approved a restructuring plan (the "Restructuring Plan"). Pursuant to the Restructuring Plan, the Corporation will distribute cash and securities to its common shareholders having an aggregate value in excess of \$617 million. The first distribution in the Restructuring Plan (the "First Distribution") is payable on April 29, 1988 to common shareholders of record on April 15, 1988 and consists of:

- (i) 49% of the common shares of the Corporation's wholly-owned subsidiary, Canterra Energy Ltd. ("Canterra"), a major Canadian oil, gas and sulphur producer;
- (ii) \$130 million aggregate principal amount of new Guaranteed Floating Rate Notes (the "Notes") to be issued by Zycor Inc., a wholly-owned subsidiary of the Corporation, and unconditionally guaranteed by the Corporation. The Notes will bear interest at a floating rate equivalent to 90-day Bankers' Acceptances plus 1.5% and will mature on May 15, 1993; and
- (iii) approximately \$77 million cash.

The value of the First Distribution on April 15, 1988 was estimated to be approximately \$387 million. However, based on trading in entitlements to receive Canterra shares and Notes on April 19, 1988, the aggregate value of the First Distribution has increased to approximately \$401 million. This represents a distribution of about \$6.23 per common share. The Toronto, Montreal and Alberta stock exchanges have conditionally approved the listing of the common shares of Canterra, and they have been posted for trading on a "when distributed" basis, subject to Canterra fulfilling all of the requirements of the exchanges on or before June 20, 1988. The closing price of the Canterra common shares on The Toronto Stock Exchange on April 19, 1988 was \$3.05.

The second distribution in the Restructuring Plan (the "Second Distribution") is payable on May 20, 1988 to common shareholders of record on May 11, 1988 and consists of new preferred shares of the Corporation (the "1988 Preferred Shares") which will be retractable at the option of the holder on and after May 31, 1993 in an aggregate face amount of \$500 million. The estimated aggregate value of the Second Distribution, at the time it is made, is in excess of \$230 million, representing \$3.57 per common share. The Toronto, Montreal and Vancouver stock exchanges have conditionally approved the listing of the 1988 Preferred Shares, subject to the Corporation fulfilling all of the requirements of the exchanges before June 16, 1988.

One effect of the payment of the two Distributions pursuant to the Restructuring Plan is that the exchange price at which holders of the Canterra 8.5% Exchangeable Subordinated Debentures (the "Canterra Debentures") may exchange the Canterra Debentures for common shares of the Corporation will be reduced. The exchange price will be reduced from \$25.50 to \$17.26 per share as a result of the First Distribution and will be reduced to approximately \$13.84 as a result of the Second Distribution. Conse-



quently, the number of common shares of the Corporation for which Canterra Debentures, other than those held by the Corporation, can be exchanged will increase from 5.9 million to about 8.7 million common shares as a result of the First Distribution and to about 10.8 million common shares after the Second Distribution. A meeting of Canterra debentureholders was held to consider substituting a conversion right into Canterra common shares in lieu of the present exchange right for the Corporation's common shares but the proposal was not approved by the holders of the Canterra Debentures.

## **NOVA'S ATTEMPTS TO GAIN CONTROL OF THE CORPORATION AND TO INFLUENCE THE RESTRUCTURING PLAN**

NOVA Corporation of Alberta ("Nova"), a petrochemical company with interests in oil and gas, is Polysar Limited's major competitor in the production and sale of ethylene in Canada. Nova is responsible for approximately 60% of the total Canadian production of ethylene and Polysar Limited is responsible for approximately 20%. Most of the ethylene which Polysar Limited produces is sold under long term contracts to DuPont Canada Inc., Nova (through Union Carbide Canada Limited) and to its own downstream production units. Polysar Limited also competes with Nova for customers for the ethylene which it produces. If Nova were to gain control of Polysar Limited, Nova would be in a position of conflict in respect of prices, quantities and other terms of Polysar Limited's future contracts with its customers, including Nova.

During October, 1987, Nova, without giving any indication of its intentions regarding Polysar Limited, began to purchase common shares of the Corporation in the market. In this month Nova purchased 6,000,000 common shares of the Corporation at prices ranging from \$9.15 to \$14.25, or a weighted average price of \$11.99 for all such shares. This was just under the maximum number of common shares that Nova could acquire without being required to publicly disclose its purchases.

From November, 1987 to January, 1988, Nova approached the Corporation on several occasions expressing an interest in purchasing Polysar Limited, the Corporation's largest subsidiary and, like Nova, a petrochemical company. The highest purchase price suggested by Nova for Polysar Limited during this period was several hundred million dollars less than management's estimate of the value of the subsidiary. Having failed to purchase Polysar Limited at less than its fair value, Nova commenced on January 29, 1988 an unsolicited take-over bid to purchase on Canadian stock exchanges up to 13,000,000 common shares of the Corporation at a price of \$14.00 per share, later increased to \$16.00 per share in response to the rise in the market price of the common shares above the original offer price.

The board of directors considered both of Nova's bids and determined that they were not in the best interests of the Corporation or its shareholders. The board recommended that shareholders retain their shares and participate in the Restructuring Plan. Holders of more than 59% of the common shares (other than Nova) chose not to tender their shares under the Nova bid. After the completion of the take-over bid and subsequent sales by Nova, Nova held approximately 24.7% of the outstanding voting securities of the Corporation, or just under the statutory maximum of 25%. (See "Shares Eligible to be Voted at the Meeting".)

On February 25, 1988, Nova requested four seats for its representatives or nominees on the Corporation's 17 person board of directors and the right to appoint its nominees to committees of the board. In addition, Nova requested that, in conjunction with the 1988 annual shareholders' meeting, management nominate an additional member of Nova management to the Corporation's board of directors and called for several of the current directors of the Corporation to be replaced by what Nova described as new "independent" directors acceptable to Nova. The present board of directors and the nominees proposed in this Management Proxy Circular consists of 17 directors, of whom 15 directors are independent of management of the Corporation.

Since Nova has indicated that it is interested in acquiring the Corporation, particularly Polysar Limited, the board is concerned that Nova's interests are in direct conflict with those of the majority of other shareholders. At its meeting on March 4, 1988 the board considered and rejected Nova's request for board representation. The board, which remains firmly committed to the Restructuring Plan, concluded that it would be detrimental to the Corporation and to shareholders, other than Nova, to permit Nova the opportunity to use board representation to impede the implementation of the Restructuring Plan and potentially gain control of Polysar Limited. The directors also considered it inappropriate for a major competitor of the Corporation in both the petrochemical and petroleum fields to gain access to confidential



information about the Corporation, which may be in direct conflict with the interests of the Corporation and its other shareholders.

On March 29 and April 5, 1988, Nova submitted a proposal the effect of which would have been to acquire the Corporation at a price that it stated would result in all common shareholders of the Corporation receiving a total value of \$22.50, being only \$13.04 per common share in addition to the two Distributions under the Restructuring Plan. Nova's proposal was conditional upon, among other things, obtaining all necessary regulatory approvals (including those necessary under the Competition Act) and shareholder approval.

The board of directors met on April 7, 1988 to consider Nova's proposal. After due consideration, the board of directors rejected Nova's proposal. The board determined that the price offered by Nova did not adequately reflect the underlying value of the Corporation, particularly in light of the Corporation's recent strong operating performance. The directors were and continue to be of the view that the Restructuring Plan together with this strong operating performance would provide shareholders with greater value than would Nova's proposal. The aggregate current market value of the First Distribution and the Corporation's common shares exceeds the value of the Nova proposal.

DuPont Canada Inc. has filed a complaint as a result of Nova's take-over bid with the Director of Investigation and Research appointed under the Competition Act (Canada). The Director may refer the matter to the Competition Tribunal. If the Competition Tribunal finds that Nova's ownership level in the Corporation is likely to prevent or lessen competition substantially, it may order Nova to dispose of all or part of its common shares as designated by the tribunal. Any attempt by Nova to acquire Polysar Limited would be subject to the same scrutiny by the Competition Tribunal, since such an acquisition would give Nova control over approximately 80% of the ethylene production in Canada, and the tribunal could, among other things, order the transaction to be dissolved.

### PRICE RANGE AND TRADING VOLUME OF COMMON SHARES

The following table sets forth the high and low sale prices and the aggregate trading volume for the common shares of the Corporation on The Toronto Stock Exchange for the periods indicated:

|      |                                           | Price range |         | Number of<br>shares traded |
|------|-------------------------------------------|-------------|---------|----------------------------|
|      |                                           | High        | Low     |                            |
| 1987 | January .....                             | \$ 8.50     | \$ 5.75 | 6,220,226                  |
|      | February .....                            | 9.50        | 8.25    | 3,494,268                  |
|      | March .....                               | 10.25       | 8.38    | 3,232,047                  |
|      | April .....                               | 11.38       | 10.00   | 9,962,612                  |
|      | May .....                                 | 12.00       | 10.63   | 3,307,583                  |
|      | June .....                                | 14.50       | 11.00   | 6,785,500                  |
|      | July .....                                | 16.38       | 13.88   | 3,814,375                  |
|      | August .....                              | 15.88       | 14.25   | 2,201,129                  |
|      | September .....                           | 15.00       | 13.13   | 4,903,342                  |
|      | October .....                             | 14.63       | 8.75    | 13,779,500                 |
|      | November .....                            | 9.88        | 8.00    | 3,344,900                  |
|      | December .....                            | 11.63       | 8.63    | 4,843,700                  |
| 1988 | January .....                             | 12.75       | 11.00   | 3,151,227                  |
|      | February .....                            | 16.25       | 13.00   | 28,480,243                 |
|      | March .....                               | 21.75       | 15.50   | 14,621,674                 |
|      | April 1 to April 8 .....                  | 21.88       | 19.75   | 5,340,518                  |
|      | April 11 to April 19 <sup>(1)</sup> ..... | 18.50       | 15.50   | 16,317,922                 |

(1) The common shares traded ex-dividend the First Distribution (estimated at \$6.03) on April 11, 1988.

The closing price of the common shares on The Toronto Stock Exchange on April 19, 1988 was \$18.00 per share.



## ELECTION OF DIRECTORS

The board of directors consists of not less than 10 and not more than 18 directors (the exact number being determined by a resolution of the board). The board has fixed the number of directors at 17. Each director will hold office until the next annual election of directors or until a successor is elected or appointed. The present board of directors and the nominees proposed in this Management Proxy Circular consists of 17 directors, of whom 15 are independent of management of the Corporation.

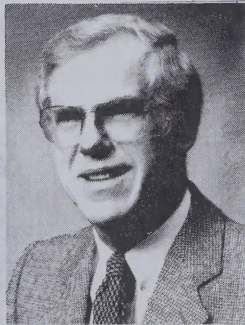
The board of directors is authorized by the by-laws of the Corporation to elect committees of its members to assist in the discharge of the board's responsibilities. The committees of the board are: the executive committee, the audit committee, the human resources and compensation committee and the nominating committee. The last paragraph of each nominee's biography identifies the committees on which such nominee currently serves.

### Nominees for Election

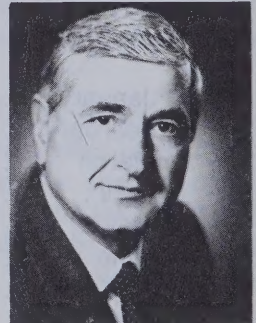
The name and a biography of the persons proposed for nomination as directors are provided below. The directors intend to vote for these nominees.

The board of directors is not aware of any circumstances that will cause any nominee to be unable to serve as a director. In the event that a nominee is unable to stand for election or to serve, the persons whose names are printed on the proxy form reserve the right to vote for another nominee at their discretion unless the shareholder has specified on the proxy form that his shares are to be withheld from voting in the election of directors.

**Edward W. Best**  
Director since 1987  
Age: 60



**John Bruk**  
Director since 1981  
Age: 58



Partner, Foster Research (management and economic consultants).

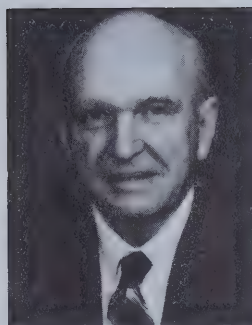
Dr. Best received his B.Sc. (1949) in Geology from the University of Western Ontario, his Ph.D. (1953) from the University of Wisconsin, and completed the Advanced Management Program (1972) at the Harvard Business School. He has held his present position since mid 1985. Prior to that he had been President of the Oil and Gas Division of BP Canada Inc. which he had joined in 1955. He is a member of the Board of Triton Canada Resources Ltd., and Fishery Products International Ltd. He is a member of several advisory boards to the Federal and Alberta Governments, and the University of Calgary. He is a past chairman of the Canadian Petroleum Association.

Deputy Chairman, Trilon Bancorp Inc. (merchant bank).

Mr. Bruk received his B.Com (1957) and LL.B (1958) from the University of British Columbia. He lectured on legal procedures at the University of Washington during 1958-59. In 1960 he was called to the British Columbia bar and practiced law in British Columbia until 1974. In 1975 he joined Cyprus Anvil Mining Corporation and was its President and Chief Executive Officer until July 1982 when he started to organize Asia Pacific Foundation of Canada, of which he was its first Chairman from June 1984 to June 1987, when he was appointed Founding Chairman. He is Chairman of First Property and Casualty Corporation, and a director of Royal LePage Limited, International Care Corporation, Weldwood of Canada Limited and Northern Dynasty Explorations Ltd., a Governor of the University of Victoria, a member of The International Council of the Asia Society, Canadian Committee of Pacific Economic Cooperation Committee, Canada-Japan Business Cooperation Committee, Canada-Taiwan Business Association and an Associate Member of Institute of Fiscal and Monetary Policy, Ministry of Finance and the Foundation for Advanced Information and Research, Japan.



**Donald G. Campbell**  
 Director since 1986  
 Age: 62



Chairman, Maclean Hunter Limited (communications company).

Following service as a flying officer with the Royal Canadian Air Force in Europe during the Second World War, Mr. Campbell worked with Price, Waterhouse & Co. Inc., Noma Lites Limited and Atomic Energy of Canada, Limited. He joined Maclean Hunter in 1957 and held various executive positions in the financial area, until he was appointed President and Chief Executive Officer in 1970, Chairman and President in 1976, and Chairman and Chief Executive Officer in 1977. Mr. Campbell is a director of Canada Life Assurance Company, Hunco Limited, Interprovincial Pipe Line Limited, Steinberg Inc., Stelco Inc., Toronto-Dominion Bank and The Toronto Sun Publishing Corporation. He is also Chairman, Research Development Corporation and Chairman of the Advisory Committee, School of Business Administration, The University of Western Ontario.

Mr. Campbell is a member of the executive committee and Chairman of the audit committee of the Corporation.

**Pierre Côté**  
 Director since 1971  
 Age: 62



Chairman of the Board of the Corporation.

Chairman, Celanese Canada Inc. (diversified manufacturer of chemicals, industrial products, fibres and fabrics).

Mr. Côté joined Laiterie Laval Limitée in 1948 and remained with this firm until his appointment as Chairman of Celanese Canada Inc. in 1979. His Directorships on Boards of Canadian companies include the Bank of Montreal, Bombardier Inc., Bouverie Inc., CAE Industries Ltd., Canadian Tire Corporation, Limited, Canron Inc., The Guarantee Company of North America, Hoechst Canada Inc., the Mutual Life Assurance Co. of Canada, and Consolidated-Bathurst Inc. He is a member of the Advisory Committee of the Royal Trust Co. In 1976 he was made a member of the Order of Canada.

Mr. Côté is chairman of the executive committee and the human resources and compensation committee of the Corporation.

**E. Kendall Cork**  
 Director since 1986  
 Age: 55

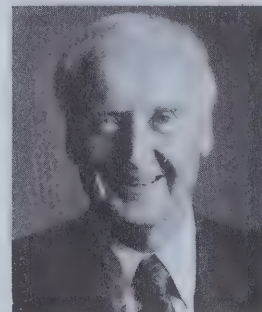


Senior Vice President — Noranda Inc. (natural resource company).

Mr. Cork graduated with a Bachelor of Commerce degree from the University of Toronto in 1954 and for five years was a colleague of Gilbert Jackson, economist and investment counsel. He joined Noranda Mines Limited in 1959. He was appointed Assistant Treasurer in 1961, Treasurer in 1963, Vice President and Treasurer in 1967. He became Senior Vice President and Treasurer in 1980 and Senior Vice President in 1987. He is a Director of The Bank of Nova Scotia, E-L Financial Corporation, and other companies. He is a member of the Governing Council of the University of Toronto, and a member of the Canadian Institute of International Affairs.

Mr. Cork is a member of the executive committee of the Corporation.

**William A. Dimma**  
 Director since 1987  
 Age: 59



Deputy Chairman, Royal LePage Limited (real estate and management company).

Mr. Dimma received his B.A.Sc. (1948) and P.Eng. (1950) from the University of Toronto, completed the Middle Management Programme (1956) at Harvard University, received an M.B.A. (1969) from York University and a D.B.A. (1973) from Harvard University. In 1948, he joined Union Carbide Canada Limited, where he was Executive Vice President and Director from 1967 to 1970. He was Professor and Dean of the Faculty of Administrative Studies, York University, from 1974 to 1976. From January 1976 to December 1978 he was President of Torstar Corporation and Toronto Star Newspapers Limited, and at January 1, 1979, he was appointed President of A.E. LePage Limited. He was President and Chief Executive Officer of Royal LePage Limited from 1984 to 1986. He is a director of Canron Inc., Continental Bank of Canada, Interprovincial Pipe Lines Limited, London Life Insurance Company, Sears Canada Inc., Sears Canada Acceptance Inc., Silcorp Limited, Trilon Financial Corporation, Trizec Corporation Ltd., Canadian Opera Company, Ballet-Opera Hall Corporation, Junior Achievement of Metropolitan Toronto, C.D. Howe Institute, Niagara Institute, a governor of York University, a trustee of the Hospital for Sick Children and several other Canadian organizations.



**Paul W. Douglas**  
Director since 1987  
Age: 61



Chairman and Chief Executive Officer, The Pittston Company (mining and marketing of bituminous coal, security transportation, air freight services and home security).

After having served in the U.S. Navy in the Pacific during 1944-45, Mr. Douglas received his B.A. in Economics from Princeton University in 1948, attended the Woodrow Wilson School of International Affairs, and was a member of the International Economic Team studying the postwar prospects of the British economy at Leeds University in England in 1948. From then until 1952, he was Chief of the Internal Finance Section of the Marshall Plan Mission (France) and also a member of the U.S. Observer Delegation to the Schuman Plan and the European Army Conference. In 1952, he joined the Freeport Company and held various positions with the company and its subsidiaries until his appointment as President and Chief Executive Officer of Freeport in 1975. From 1981 until August 1983 he was also President and Chief Executive Officer of Freeport-McMoRan Inc. He has held his present position since 1984. Mr. Douglas is a director of the New York Life Insurance Company, Phelps Dodge Corporation, Philip Morris Companies, the United States Trust Company of New York, and the France Fund.

**Patrick J. Keenan**  
Director since 1985  
Age: 56



Chairman and Chief Executive Officer, Keewhit Investments Limited (investment holding company).

Mr. Keenan graduated in Commerce from McGill University and became a Chartered Accountant in 1957, a Chartered Secretary in 1959 and a Fellow of the Institute of Chartered Accountants of Ontario in 1988. He joined the Patino Group in 1964 as Controller. He served the Group in London, England, from 1970 to 1975 as Chief Executive Officer and subsequently Vice Chairman of its subsidiaries, Consolidated Tin Smelters Ltd. and Amalgamated Metal Corporation Ltd. In 1975 he was appointed President and Chief Executive Officer of the parent, Patino N.V., and continued in this role until 1981 when he sold his interest along with other major shareholders. Since that date he has been active in developing Keewhit, his family investment company, and in serving as a director in Brascan Limited, London Life Insurance Company, Westmin Resources Limited, Canada Development Investment Corporation, Belmoral Mines Ltd., The Hume Group Ltd., Barnes Wines Limited, St. Michael's Hospital, Grenville Christian College and several other corporations.

Mr. Keenan is a member of the executive committee and the human resources and compensation committee of the Corporation.

**Bernard F. Isautier**  
Director since 1986  
Age: 45



President and Chief Executive Officer of the Corporation

Mr. Isautier is a graduate of the Polytechnique School, the Mining School of Paris and the Institute of Political Sciences in Paris. From 1968 to 1970, Mr. Isautier served as Advisor on Uranium to the President of the Republic of Niger. In 1970, he joined the Ministry of Industry in Paris, France, and in 1973 he became Advisor to the Minister for Energy and Mines. In 1976, he joined the Elf Aquitaine Group as General Manager of its subsidiary in Tunisia.

Mr. Isautier came to Canada as President of Aquitaine Company of Canada Ltd. in September 1978. Following the acquisition of Aquitaine in June 1981, the Corporation grouped all of its oil and gas interests in Canterra Energy Ltd. Mr. Isautier served initially as President and Chief Executive Officer of Canterra and became Chairman in January 1986, at which time he was also named Executive Vice President of the Corporation. He was appointed President and Chief Operating Officer of the Corporation in September 1986 and he assumed his present position in May 1987. Mr. Isautier is a director of Credit Lyonnais Canada, Falconbridge Limited, CDC Life Sciences Inc. and past Chairman of the Canadian Petroleum Association.

Mr. Isautier is a member of the executive committee of the Corporation.

**Gualtherus Kraijenhoff**  
Director since 1987  
Age: 65



President, Supervisory Council, Akzo N.V. (chemical company).

Following service in the Royal Air Force from 1942 to 1947, Mr. Kraijenhoff joined N.V. Organon in Holland. From 1971 to 1978, he was Chairman of the Board of Management of Akzo N.V., was nominated member of the Supervisory Council in 1978 and assumed his present position in 1980. He was President of The Netherlands Red Cross from 1966 to 1986 and Vice Chairman of the League of Red Cross Societies from 1973 to 1986. He is also President of the Board of Directors of Verenigde Bedrijven Tiemstra B.V., a director of Enka AG, of S.G. Warburg & Co. International B.V., of Douwe Egberts Koninklijke Tabak-fabriek-Koffiebranderijen-Theehandel B.V., of Sara Lee Corporation, of S.G. Warburg plc, and of APV PLC, a member of the Advisory Board of New Perspective Fund Inc., and Chairman of the Advisory Council of the Netherlands Foreign Investment Agency.



**Bernard Lamarre**  
Director since 1985  
Age: 56



Chairman and Chief Executive Officer, Lavalin Inc. (engineering company and construction company).

Mr. Lamarre received his engineering degree from l'Ecole polytechnique, Université de Montréal, in 1952, and an M.Sc. in engineering from the University of London, England in 1955. He joined the firm of Lalonde & Valois which he was instrumental in developing into Lavalin, of which he is Chairman and Chief Executive Officer. In addition to being an officer or director of the 40 subsidiaries of the Lavalin group of companies. Mr. Lamarre is a director of La Laurentienne Générale, of La Banque Nationale du Canada, of Canadian General Electric, of the Royal Victoria Hospital, and chairman of the Board of the Montreal Museum of Fine Arts. In 1985 he was appointed an officer of the Order of Canada and an officer of the Order of Quebec.

Mr. Lamarre is a member of the audit committee of the Corporation.

**John R. McCaig**  
Director since 1981  
Age: 58



Chairman and Chief Executive Officer, Trimac Limited (bulk highway transportation and contract drilling).

Mr. McCaig joined the family trucking business, Maccam Transport Ltd., in 1947 and when Trimac Transportation Ltd. was formed in 1961 he became president. The firm expanded into contract drilling in the late 1970's with the acquisition of Kenting Limited and, later, the Cactus Drilling companies of Dallas. He is a director of Trimac Limited, Pan-Alberta Gas Ltd., Bantrel Group Engineers Ltd., BCE Development Corporation, Northern Transportation Company Limited, and Banister Continental Ltd.

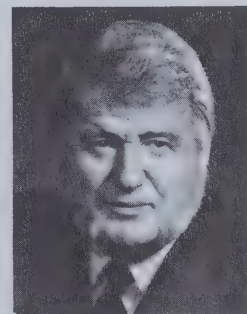
Mr. McCaig is a member of the executive committee and of the human resources and compensation committee of the Corporation.

**Donald D. Lougheed**  
Director since 1986  
Age: 63



Mr. Lougheed was Executive Vice President and a director of Esso Resources Canada Limited from 1981 until his retirement in September 1986. He graduated in mining engineering from the University of Alberta in 1948, and upon graduation joined Imperial Oil Limited. He had assignments in Calgary, Edmonton, Regina and Toronto and also with Exxon affiliates in Tulsa, Oklahoma, and New York City. He was appointed a Vice President of Imperial Oil Limited in 1972, was elected a director in 1975 and appointed a Senior Vice President until 1981. Mr. Lougheed is a Vice President of Calgary Chamber of Commerce.

**J. William E. Mingo**  
Director since 1981  
Age: 61



Partner of Stewart MacKeen & Covert (barristers and solicitors).

Mr. Mingo is a graduate of Dalhousie and Columbia Universities. He was admitted to the bar of Nova Scotia in 1950 and then joined Stewart MacKeen & Covert. He was appointed Q.C. in 1966 and is past president of the Nova Scotia Barristers' Society. Mr. Mingo is a director of The Royal Bank of Canada, Maritime Telegraph & Telephone Company Limited, Sun Life Assurance Company and other Canadian companies.

Mr. Mingo is a member of the audit committee of the Corporation.



**Maurice J. Moreau**  
Director since 1971  
Age: 61



Mr. Moreau was Executive Vice President and Chief Operating Officer, Eldorado Nuclear Ltd. until his retirement in August, 1984. He is a graduate in engineering (B.Sc.) of the University of Saskatchewan. In 1954, he founded Geosearch Consultants Ltd. In August, 1975 he joined Eldorado Nuclear Limited as General Manager — Exploration and was appointed Executive Vice President and Chief Operating Officer in November 1979. Mr. Moreau was also President of Eldorado Resources Limited, Eldor Resources Limited and Eldorado Aviation Limited.

Mr. Moreau is a member of the audit committee of the Corporation.

**John D. Redfern**  
Director since 1987  
Age: 52



Chairman of the Boards of Lafarge Canada Inc. (cement manufacturer, construction materials and waste management), and Lafarge Corporation, Reston, Virginia.

Mr. Redfern received his civil engineering degree from Queen's University in 1958. He then joined Canada Cement Company, holding different positions across the country, becoming President and Chief Executive Officer in 1977. He was appointed President and Chief Executive Officer of the holding company, Lafarge Corporation, in March 1983; in May 1984, he was appointed Chairman of Lafarge Canada Inc.; and in February 1985, Chairman of Lafarge Corporation. He is a member of the Advisory Board of the Centre of Management Development — Northeastern University (Boston); of the Board of Governors of Le Conseil du Patronat du Québec; the Board of Governors of Carleton University (Ottawa). He is also a member of: the Canadian Manufacturers Association; the Canadian Chamber of Commerce; the Canadian Construction Association, and past Chairman of the Portland Cement Association. He is a Director of: General Portland Inc., Lafarge Canada Inc., Lafarge Corporation, Lafarge Coppel (Paris) and Montreal Trust.

**William P. Wilder**  
Director since 1985  
Age: 65



Mr. Wilder was Chairman of the Board, The Consumers' Gas Company Ltd. until his retirement in September 1987. He served in the R.C.N.V.R. on loan to the Royal Navy during the Second World War. He received a B. Comm. from McGill University in 1946 and an M.B.A. from the Harvard Graduate School of Business Administration in 1950. He joined Wood Gundy in 1946 and became its president in 1967-72. He was Chairman of the Canadian Arctic Gas Study Group from 1972 to 1977; Executive Vice President of Gulf Canada, 1977-79; President and Chief Executive Officer, Hiram Walker Resources Ltd. (and predecessor Hiram Walker-Consumers Home Ltd.) 1979-82; and Deputy Chairman, Hiram Walker Resources Ltd., May 1982-February 1984. He holds directorships on the boards of BGR Precious Metals Inc., Budd Canada Inc., Canada Life Assurance Company, John Labatt Limited, Maclean Hunter Ltd., NIM Management Limited, Noranda Inc., The Royal Bank of Canada, Sears Canada Inc., and United Corporations Ltd.

Mr. Wilder is a member of the executive committee of the Corporation.



## Share Ownership of Directors

The following table shows the number of shares beneficially owned or controlled directly or indirectly by the nominees for election as directors.

|                              | <u>Common<br/>Shares</u> |
|------------------------------|--------------------------|
| Edward W. Best .....         | 1,000                    |
| John Bruk .....              | 3,740                    |
| Donald G. Campbell .....     | 13,890                   |
| E. Kendall Cork .....        | 5,000                    |
| Pierre Côté .....            | 15,263                   |
| William A. Dimma .....       | 10,500                   |
| Paul W. Douglas .....        | 10,000                   |
| Bernard F. Isautier .....    | 39,177                   |
| Patrick J. Keenan .....      | 100,000                  |
| Gualtherus Kraijenhoff ..... | 1,000                    |
| Bernard Lamarre .....        | 2,100                    |
| Donald D. Loughheed .....    | 1,000                    |
| John R. McCaig .....         | 1,100                    |
| J. William E. Mingo .....    | 15,100                   |
| Maurice J. Moreau .....      | 2,286                    |
| John D. Redfern .....        | 1,000                    |
| William P. Wilder .....      | 30,000                   |

The above information was furnished by each nominee.

## REMUNERATION OF DIRECTORS

Under the current remuneration policy of the Corporation, each director receives an annual fee of \$8,000. There is an additional annual fee of \$5,000 for membership on the executive committee and \$3,000 for membership on the audit committee. No additional fee is paid for membership on the human resources and compensation committee or the nominating committee. The chairman of the audit committee receives an additional annual fee of \$1,000. A fee of \$600 per meeting is paid for each meeting of the board of directors or of any committee of the board of directors attended by a member. However, if a committee meeting is held on the same day as a meeting of the board of directors, and lasts less than one-half hour, the fee is \$150. The Corporation's employees who are also directors of the Corporation or any of its subsidiaries do not receive compensation for service as a member of those boards or any of their committees. If two committees hold a joint meeting, only one fee is paid. For participation by telephone at a meeting that lasts less than one-half hour, the fee is \$150.

The information set out in the table below includes the aggregate of all fees paid to directors for serving on the board of directors of the Corporation and its committees. The table also sets out the remuneration received by those directors who also serve as directors of subsidiaries in accordance with the remuneration policies of those subsidiaries.

|                                    | <u>Directors' fees<br/>paid in 1987</u> |
|------------------------------------|-----------------------------------------|
| Remuneration of directors as such  |                                         |
| Number of directors: 24 (1)        |                                         |
| Corporation incurring the expense: |                                         |
| The Corporation .....              | \$334,175                               |
| Canterra .....                     | 64,067                                  |
| Polysar Limited .....              | 69,500                                  |
| Total .....                        | <u>\$467,742</u>                        |

(1) The number of persons who served as directors during 1987.



## EXECUTIVE COMPENSATION

### Cash Compensation

The following table sets forth the total cash compensation paid to the 12 persons who were the Corporation's executive officers for 1987.

| Remuneration of executive officers | Salary             | Bonus              | Other remuneration | Total              |
|------------------------------------|--------------------|--------------------|--------------------|--------------------|
| Paid by the Corporation.....       | \$ 992,255         | \$ 748,150         | \$ —               | \$1,740,405        |
| Paid by Canterra .....             | 318,502            | 62,100             | 30,480             | 411,082            |
| Paid by Polysar Limited .....      | 488,267            | 480,900            | 59,945             | 1,029,112          |
| Total .....                        | <u>\$1,799,024</u> | <u>\$1,291,150</u> | <u>\$90,425</u>    | <u>\$3,180,599</u> |

### Compensation Pursuant To Plans

**Annual Incentive Plan** — Annual cash bonus awards may be granted to officers (and other key employees) as determined by the human resources and compensation committee of the board of directors of the Corporation in the month of March. This determination is based on the financial results of the Corporation compared with pre-determined targets as well as the individual performance of each officer during the year under review. The amount of the awards paid in respect of the 1987 fiscal year is shown in the above table.

**Stock Option Plan** — In 1987, options to purchase 431,425 common shares were granted to executive officers at an average exercise price of \$10.38 per common share. In 1987, executive officers exercised 135,000 options. The aggregate net value of the options exercised (i.e. the respective market values of the optioned shares less the exercise prices of such shares on the dates that the options were exercised) was \$803,900. (See "Employee Stock Option Plans".)

**Retirement Plans** — Executive officers participate in non-contributory defined benefit plans (the "Pension Plans") established for all employees. In addition, agreements providing for supplementary retiring allowances ("Supplementary Allowances") have been entered into between the Corporation and certain officers selected on the basis of length of service. The amounts payable to officers under the Pension Plans, when supplemented by Supplementary Allowances, are based on years of service and the average of the best consecutive thirty-six calendar months of pensionable earnings. The amounts payable upon retirement at age 65 will be 2% of the average pensionable earnings multiplied by the number of years of service, less an amount to offset in part sums received from the Canada Pension Plan.

The cost of funding Supplementary Allowances in 1987 was \$23,300. No amounts are contributed or charged to the Pension Plans with respect to benefits which are payable as Supplementary Allowances.

### Employee Stock Option Plans

Under the 1985 Employee Stock Option Plan, options are granted from time to time to employees to purchase common shares of the Corporation at an exercise price equal to the closing price of the common shares on The Toronto Stock Exchange on the date of a grant. The selection of participants and the number of options is determined by the human resources and compensation committee of the board of directors of the Corporation, based on factors such as impact on corporate financial performance and attainment of long-term strategic goals, responsibilities, salary levels and, to a lesser degree, length of service.



As at April 15, 1988, the options outstanding to purchase common shares under the 1985 Employee Stock Option Plan are:

|                                                               | <u>Common shares<br/>under option</u> | <u>Exercise price</u> | <u>Expiration date</u> |
|---------------------------------------------------------------|---------------------------------------|-----------------------|------------------------|
| Executive officers of the Corporation as a group (nine) ..... | 436,860                               | \$ 4.0344             | September 16, 1996     |
|                                                               | 524,778                               | 5.8370                | March 17, 1995         |
|                                                               | 72,810                                | 6.7812                | March 18, 1996         |
|                                                               | 120,173                               | 6.8670                | April 14, 1997         |
|                                                               | 238,671                               | 7.5537                | May 9, 1997            |
|                                                               | 50,967                                | 9.5280                | June 27, 1997          |
|                                                               | 218,430                               | 10.3863               | August 5, 1997         |
| Executive officers of subsidiaries as a group (six) .....     | 333,033                               | 7.5537                | May 9, 1997            |
|                                                               | 58,248                                | 10.8155               | March 3, 1998          |
| Other employees of the Corporation as a group                 | 228,055                               | 5.8370                | March 17, 1995         |
|                                                               | 6,553                                 | 6.7812                | March 18, 1996         |
|                                                               | 97,347                                | 6.8670                | April 14, 1997         |
| Other employees of subsidiaries as a group .....              | 196,296                               | 7.5537                | May 9, 1997            |
|                                                               | 52,278                                | 10.8155               | March 3, 1998          |
|                                                               | 464,100                               | 14.6782               | April 7, 1998          |

(1) After giving effect to the adjustments required as a result of the First Distribution.

When Canterra became a wholly-owned subsidiary of the Corporation effective September 30, 1987, the Canterra Employee Stock Option Plan was amended and each optionholder became entitled, upon exercise of his options, to purchase common shares of the Corporation instead of Canterra common shares. In 1987, no options were granted under the Canterra Employee Stock Option Plan.

As at April 15, 1988, the options outstanding to purchase common shares of the Corporation under the Canterra Employee Stock Option Plan are:

|                                                  | <u>Common Shares<br/>under option</u> | <u>Exercise price</u> | <u>Expiration date</u> |
|--------------------------------------------------|---------------------------------------|-----------------------|------------------------|
| Executive officers of Canterra as a group (nine) | 134,240 (1)                           | \$6.6953              | January 1, 1992        |
|                                                  | 53,394 (1)                            | 6.6953                | December 5, 1993       |
| Other employees of Canterra as a group .....     | 97,380                                | 6.6953                | January 1, 1992        |

(1) Executive officers of the Corporation who are also executive officers of Canterra hold 172,249 of these options.

(2) After giving effect to the adjustments required as a result of the First Distribution.

The 1985 Employee Stock Option Plan and the Canterra Employee Stock Option Plan have been amended to provide for adjustment of the number of common shares of the Corporation under option and the exercise price per share to reflect extraordinary distributions to holders of common shares. The stock exchanges have approved these amendments. Following the adjustments which would be made pursuant to the amendments as a result of the Second Distribution under the Restructuring Plan, it is expected that shares subject to option under these plans will not exceed 10% of the outstanding common shares of the Corporation.

### **Other Compensation**

The aggregate value of other compensation paid to executive officers of the Corporation for the financial year ended December 31, 1987 did not exceed the lesser of \$10,000 times the number of executive officers and 10% of the aggregate cash compensation of the executive officers as a group.

### **Termination Arrangements**

The termination agreement with the President of the Corporation provides that certain events constitute termination entitling him to certain payments, benefits and other rights. These events include: a termination other than for cause; a material reduction in the size of the assets of the Corporation; and a change in control of the Corporation (which is defined in terms of an acquisition of 20% or more of the voting shares) following which the President determines that he is no longer satisfied with his working environment. In the event of termination, the President is to continue to be paid his remuneration and benefits for a three-year period and his existing stock options become vested.



The agreements with nine other executive officers are similar but contain more limited termination rights arising on a change in control of the Corporation and entitle the executive to remuneration and benefits for two and a half years.

Another executive officer was entitled, upon termination of his employment which occurred in 1987, to receive in the aggregate, the equivalent of 19 months of his last monthly compensation, payable in equal annual payments over nine years plus certain fringe benefits for a period of approximately two and one-half years.

#### **Indebtedness**

In January 1987, Mr. N.G.D. Gray had an outstanding interest-free housing loan amounting to \$16,625 which has since been reduced to \$14,750.

#### **Liability Insurance**

The directors and officers of the Corporation and its subsidiaries as a group are insured against certain liabilities pursuant to directors' and officers' liability insurance policies covering the Corporation and its subsidiaries. The general effect of these policies is that, if during the policy period any claims are made against such directors or officers for a wrongful act (as defined in the policy) while acting in their capacities as directors or officers, the insurers will pay for the loss (as defined in the policy) which the directors or officers become obligated to pay, up to an aggregate limit of U.S. \$25,000,000 worldwide each policy year. The corporate reimbursement deductible is U.S. \$500,000 per loss.

In 1987, the portion of the total premium attributable to directors and officers of the Corporation as a group was U.S. \$122,037 and was paid by the Corporation.

#### **APPOINTMENT OF AUDITORS**

The persons whose names are printed on the proxy form intend to vote for the reappointment of Thorne Ernst & Whinney, Chartered Accountants, as auditors of the Corporation. Thorne Ernst & Whinney (or their predecessors) have been the auditors of the Corporation since its establishment in 1971.

#### **SHARES ELIGIBLE TO BE VOTED AT THE MEETING**

Except as provided below, only holders of common shares of record at the close of business on April 20, 1988 will be entitled to notice of and to vote in person or by proxy at the Meeting or any adjournment thereof. A transferee of common shares after that day will be entitled to vote the shares upon (i) establishing that he owns such shares and (ii) making a written demand to be added to the shareholders' list, both at least 10 days before the date of the Meeting, to the Secretary of the Corporation at the registered office in Toronto or at an office of the transfer agent of the Corporation.

As of April 15, 1988 there were outstanding 64,330,754 common shares, each of which carries one vote.

In accordance with the Canada Development Corporation Reorganization Act, the articles of the Corporation contain provisions limiting the ownership, by a person or persons associated with them, of securities which carry more than 25% of the votes in the case of a resident of Canada (as defined) and more than 10% in the case of a non-resident (as defined). In addition, non-residents, in the aggregate, may not hold securities carrying more than 25% of the votes. Shares held in contravention of these provisions are not entitled to be voted. Management is not aware of any shares held in contravention of the articles of the Corporation.

Any matter that is submitted to a vote of shareholders at the Meeting will be determined by a majority of votes cast, either upon a show of hands or upon a ballot. In case of any equality of votes, the Chairman of the Meeting will not be entitled to a second or casting vote.

#### **Principal Holders of Securities**

To the knowledge of the directors and officers of the Corporation, as of April 15, 1988, the only person which beneficially owned, or exercised control or direction over, directly or indirectly, more than 10% of the shares of any class of voting shares of the Corporation was Nova, Calgary, Alberta, which was, at that date, the registered and beneficial holder of 16,000,000 common shares representing approximately 24.9% of the common shares and voting rights attaching to all voting shares.



As at April 15, 1988, the directors and officers of the Corporation as a group owned beneficially, directly or indirectly, less than one-half of one percent of the common shares of the Corporation.

## SOLICITATION OF PROXIES

The solicitation of proxies will be primarily by mail but proxies may also be solicited personally or by telephone by regular employees of the Corporation without special compensation. In addition, the Corporation has retained the services of Wood Gundy Inc., as agent, to manage a soliciting dealer group to solicit proxies on behalf of management of the Corporation. The Corporation will pay Wood Gundy Inc. a fee of \$100,000 to manage the solicitation of proxies and will reimburse reasonable out-of-pocket expenses. In addition, the Corporation will pay a fee of \$15 for each 1,000 common shares (subject to a minimum fee of \$25 and a maximum fee of \$1,500 in respect of all common shares beneficially owned by any one shareholder) for proxies voted for the election of nominees named in this Management Proxy Circular and received by the Corporation through investment dealers.

The Corporation will also pay brokers or nominees holding common shares in their names or in the names of their principals for their reasonable expenses in sending solicitation materials to their principals.

No person is authorized to give any information or to make any representations other than those contained in this Management Proxy Circular and, if given or made, such information or representations must not be relied upon as having been authorized to be given or made.

### Proxies

Shareholders who are unable to be present at the Meeting may still vote through the use of proxies. By completing and returning the enclosed proxy form, you can participate in the Meeting through the person or persons named on the form. **Please indicate the way you wish to vote on each item of business and your vote will be cast accordingly. If you do not indicate a preference, the shares represented by the enclosed form of proxy, if the same is executed in favour of management nominees and deposited as provided in the Notice of Meeting, will be voted in favour of all matters identified in such Notice of Meeting.**

**The proxies confer discretionary authority upon the persons named with respect to amendments to the above matters or on other matters which may come before the Meeting, as the case may be, and will be voted on such amendments and other matters in accordance with the best judgment of the person voting the proxy.** Management of the Corporation knows of no other matters which may come before the Meeting.

### Alternate Proxy

**A shareholder has the right to nominate a person other than those designated on the accompanying form of proxy by crossing out the printed names and inserting the name of the person he or she wishes to act as proxy, or by completing another proxy form.** Proxy forms which appoint persons other than those whose name is printed on the form should be submitted to the appointed person rather than returned to the Corporation. A person acting as proxy need not be a shareholder of the Corporation.

### Revocation of Proxies

A proxy may be revoked by written notice from the shareholder or the shareholder's authorized representative. If the shareholder is a corporation, notice of revocation of proxy must be endorsed with the corporate seal by an officer or by an authorized attorney. Notice of revocation of proxy must be deposited either at the offices of the Corporation in Toronto, at any time up to 5:00 p.m. on May 24, 1988 (or the last business day preceding any adjournment of the Meeting), or with the Chairman of the Meeting prior to the commencement of the Meeting on the day of the Meeting or any adjournment. A proxy may also be revoked in any other manner permitted by law.



## DIRECTORS' APPROVAL

The contents and sending of this circular have been approved by the board of directors. The information is as of April 20, 1988, except where otherwise noted.

A handwritten signature in cursive script that reads "Claude Marchand".

CLAUDE R. MARCHAND,  
Senior Vice President and Secretary

Toronto, April 20, 1988

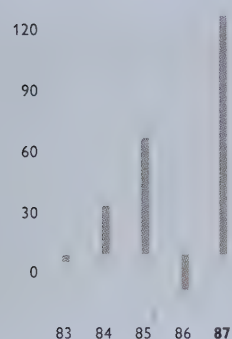




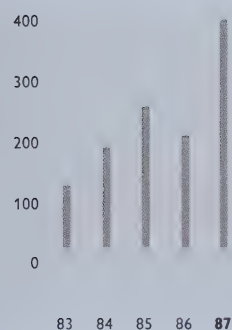




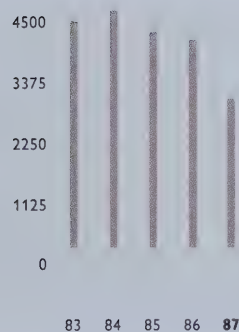
**Earnings from Operations before Write-Downs**  
(millions of dollars)



**Free Cash Flow from Operations**  
(millions of dollars)



**Long-Term Debt**  
(millions of dollars)



**FINANCIAL HIGHLIGHTS**

(millions except per share amounts)

Polysar Energy & Chemical Corporation

| Year ended December 31                        | 1987             | 1986       |
|-----------------------------------------------|------------------|------------|
| Revenue                                       | <b>\$2,868.5</b> | \$2,604.7  |
| Energy                                        |                  |            |
| Operations before write-downs                 | <b>(17.8)</b>    | (10.7)     |
| Write-down of property                        | <b>-</b>         | (218.0)    |
| Petrochemicals and polymers                   | <b>141.3</b>     | 13.0       |
| Corporate                                     | <b>(4.2)</b>     | (21.0)     |
| Income (loss) from operations                 | <b>119.3</b>     | (236.7)    |
| Equity in earnings of discontinued operations | <b>0.7</b>       | (70.9)     |
| Non-recurring items                           | <b>107.5</b>     | 10.8       |
| Net income (loss)                             | <b>\$ 227.5</b>  | \$ (296.8) |
| Per common share                              |                  |            |
| Income (loss) from operations                 | <b>\$ 1.33</b>   | \$ (7.73)  |
| Net income (loss)                             | <b>\$ 3.39</b>   | \$ (9.31)  |

Polysar Energy & Chemical Corporation is a private sector enterprise whose common shares trade on the Toronto, Montreal and Vancouver exchanges (Symbol: PYC). Formerly known as Canada Development Corporation, it has operating assets in petroleum and sulphur that comprise its Energy division, and primary, intermediate and related downstream petrochemicals which operate through its Petrochemical and Polymer divisions.

**To our shareholders:**

The past year was one of significant accomplishment for the Corporation in achieving its major goal of improving returns for its shareholders. A major turnaround occurred in operating performance in 1987, led by a strong recovery in earnings in the Basic Petrochemical division. The Corporation continued to strengthen its financial position by disposing assets, raising common equity, and reducing debt and coupon-bearing obligations. Early in 1988, the Corporation put forward a restructuring plan to provide its common shareholders with improved values for their holdings. The core businesses continued creating additional value for shareholders through their emphasis on operating excellence and international competitiveness. And finally, the Corporation changed its name to reflect its transition to a totally private-sector enterprise.

**Review of 1987**

Strong economic conditions in the markets served by our petrochemical operations resulted in a solid financial performance for 1987, which was much improved from previous years. Consolidated income from operations totalled \$119.3 million, up sharply from a restated loss of \$236.7 million in 1986. On a per share basis, the 1987 income from operations represented \$1.33 per share (\$1.26 fully diluted), compared with a loss of \$7.73 per share in 1986. Non-recurring items of \$108.2 million increased net income for 1987 to \$227.5 million or \$3.39 per common share (\$2.64 fully diluted), compared with a restated loss of \$296.8 million in 1986 or \$9.31 per common share.

The improvement in performance was largely attributable to higher prices and demand for products produced by the Basic Petrochemical division, particularly ethylene and styrene, as well as a strong performance in plastics in the United States. Strong performances can be expected in 1988 from our basic petrochemical operations because of the tight supply conditions and the absence of new capacity coming on stream in the medium term. While operating profit in rubber declined somewhat during the early part of 1987 as a result of a squeeze on margins from higher raw material costs, this business finished 1987 strongly, with profit during the fourth quarter exceeding that of the year-earlier period.

The Energy division had an excellent year in expanding its asset base, more than replacing all of its 1987 production of oil and gas liquids and natural gas on an oil equivalent basis through successful exploration programs and enhanced recovery efforts. Once again, Canterra Energy Ltd. was one of Western Canada's lowest-cost explorers for hydrocarbon resources and its consistent record in this area is an enviable one. However, the operations of the division were affected by the continued weakness in the world's sulphur market, which reduced selling prices and volumes sold during the year. Nevertheless, Canterra made further progress in improving its financial strength, reducing its long-term debt by \$400 million during the year.



Pierre Côté  
Chairman of the Board



## Financial Initiatives

As last year's annual report indicated, a strategic review of the Corporation's investments and financial condition led to a decision to focus primarily on our operations in petroleum, sulphur and petrochemicals. Our disposition program, which started in mid-1986, continued in earnest last year, and will be successful in raising for the Corporation about \$1.6 billion through the sale of assets over a two-year period. This program of selling assets is now largely completed.

During the past year, the Corporation disposed of its remaining interests in CDC Life Sciences Inc., Falconbridge Limited, and AES Data Inc., raising almost \$550 million.

In a transaction that is expected to be completed before the end of May 1988, the Corporation will sell for about \$500 million its latex business to BASF AG of West Germany. In deciding to sell the latex business, the Corporation was convinced that the most significant opportunities for growth in earnings within the Polymer division are in its rubber and plastics businesses. There will be little net impact on the Corporation's future earnings and cash flow from this sale.

The Corporation received \$150 million in cash from the settlement of a contract dispute with Ontario Hydro dating back a number of years. Also achieved was the removal, through a defeasance scheme, of preferred shares valued at \$138 million in a subsidiary of the Corporation.

To further improve financial strength, the Corporation undertook two common share financings during the year that raised \$90 million. The Class B Preferred shares were called for redemption and about 95% were converted into common shares. Early in 1988, Union Carbide Canada Ltd. and an affiliate agreed to exchange \$114.4 million of preferred shares in the Corporation for 4.65 million common shares. This latter transaction was particularly gratifying: the Corporation eliminated a quarterly dividend obligation and the need to redeem these preferred shares in the future, while issuing common shares from treasury at \$24.60 per share.

As a result of profitable operations, the sale of assets, and these other financial initiatives, common shareholders' equity in the Corporation has increased by \$382 million in 1987. The Corporation has reduced its coupon-bearing capital by \$1.3 billion, by paying off almost \$1 billion of its indebtedness, while minority interests and preferred stock outstanding were reduced by \$319.1 million.

## Increasing Value for Shareholders

For some months, a number of plans were reviewed to increase shareholders' values – based on the promising operating outlook and improved financial strength that were not being recognized by the stock market. In early 1988, the Board approved a restructuring plan to distribute to common shareholders cash and



Bernard F. Isautier  
President and  
Chief Executive Officer

securities with an expected fully-distributed aggregate value that could exceed \$900 million if the 1980 Preferred shares are fully converted into common shares of the Corporation. This distribution of cash and securities, worth up to \$10.45 per common share, is currently being implemented.

The restructuring plan will take until mid year to complete. Your directors are confident that the plan has improved the values ascribed to the Corporation by the marketplace.

### **The Future**

The Corporation's energy and petrochemical operations have excellent prospects. Your Board intends to manage the affairs of the Corporation so that these prospects are translated into real value for all shareholders. We look forward to this challenge.

During the past year, a number of directors resigned from the boards of Canterra and Polysar as well as the Corporation. To all, we thank you for your service and the valuable contribution made to the Corporation over the years. To each of our employees, we say thank you for your efforts in a challenging environment and know that we can depend upon you – our greatest asset – in the months and years ahead.

On behalf of the Board of Directors,



Pierre Côté  
*Chairman of the Board*



Bernard F. Isautier  
*President and Chief Executive Officer*

March 4, 1988.



## PETROCHEMICALS AND POLYMERS

The Corporation is the sole owner of Polysar Limited, a major multinational producer and marketer of a diverse range of petrochemical and polymer products. Polysar's petrochemical and polymer operations had an excellent year. The company contributed \$172.4 million to the 1987 results of the Corporation, compared with \$13.0 million in 1986. The 1987 results include non-recurring items (net of tax) of \$31.1 million. Revenue of \$2.5 billion was up 20% from 1986.

### Basic Petrochemical Division

The Basic Petrochemical division underwent a spectacular turnaround during 1987, achieving a contribution from operations of \$135 million, compared with a loss of \$52 million in 1986. Sales during 1987, which included products used by the Polymer division, totalled \$1.1 billion compared with \$864 million during 1986. This improvement resulted from strong market conditions that in turn produced higher petrochemical prices, successful management programs to reduce operating costs, and stable feedstock costs.

The Basic Petrochemical division consists of several operations in or near Sarnia, Ontario. The largest manufacturing facility is the Corunna plant, an integrated refinery and petrochemical complex capable of producing 2.8 billion pounds of primary petrochemicals annually including 1 billion pounds of ethylene, a variety of intermediate petrochemical products and various fuel products. The division manufactures styrene monomer at a separate facility near Sarnia with annual capacity of 600 million pounds. It is a 50% owner of CanStates Energy, a marketer of natural gas and natural gas liquids, and holds a 25% interest in a fractionation plant in Marysville, Michigan.

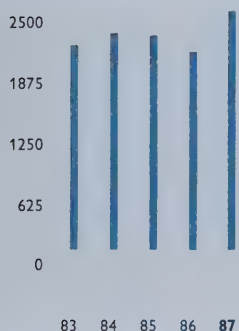
During the past year, the division processed 16.6 million barrels of crude oil and natural gas condensate and 130.4 million gallons of natural gas liquids into 5.5 billion pounds of petrochemical products. This included 990 million pounds of ethylene, 610 million pounds of propylene and 610 million pounds of styrene. Ethylene and styrene accounted for 18% and 35% respectively of the group's revenue during 1987. About 40% of the petrochemical volume produced during the past year, worth \$480 million, was consumed by the Polymer division to manufacture rubber, plastics and latex products.

**Markets:** The global supply/demand for many petrochemical products tightened during 1987, leading to substantial price increases. For example, the price of styrene monomer rose from 26¢ per pound (U.S.) in January to 40¢ (U.S.) at year end, while ethylene moved from 14.25¢ (U.S.) to 19.5¢ (U.S.) per pound at year end. During early 1988, prices for styrene and ethylene strengthened further. Since feedstock costs (crude oil, condensate and natural gas liquids) remained relatively stable, margins for petrochemical products rose to their highest levels in recent years.

Production of ethylene and styrene in North America is running at operating capacity. Significant capacity additions are not expected during the next few years. With a buoyant economy, the market for styrene and ethylene should remain tight for the next few years.

**Competition:** During recent years, the division has concentrated on reducing costs and maximizing product values to maintain its competitiveness with the U.S. Gulf Coast. This has resulted in increased profitability and reduced vulnerability to periods of lower demand and shifts in feedstock prices.

**Petrochemicals and Polymers  
Revenue**  
(millions of dollars)



U.S. Gulf Coast producers have some feedstock and transportation cost advantages because of their proximity to ocean transportation and oil and gas fields located in Texas and Louisiana. However, the division's location in the Sarnia area provides advantages in the form of lower electricity costs and closeness to large U.S. markets.

A key objective of the division has been to increase its overall flexibility, allowing it to respond quickly to market conditions. In particular, programs have focused on increasing its ability to use the cheapest feedstock available at any particular time, obtaining access to more sources of feedstocks, upgrading product values, increasing production efficiencies and improving product netbacks.

During 1987, the division obtained the full benefit of one important program to allow the processing of either crude oil or natural gas liquids. The Corunna plant completed its first full year of processing both feedstocks and now can use up to 40% of its capacity to process natural gas liquids. During the past year, natural gas liquids were about 50% cheaper than crude oil and this flexibility contributed to significant cost reductions.

The division has strengthened its ability to move natural gas liquids through its partnership in CanStates Energy. The division's feedstock position was strengthened during 1987 when Alberta Natural Gas Company Ltd. became Polysar's new partner in the venture. CanStates' joint venture completed a \$30 million fractionation plant in Marysville, Michigan. The plant is connected to the Sarnia facilities by pipeline and can process natural gas liquids to commercial specifications for sale or use at the Corunna site.

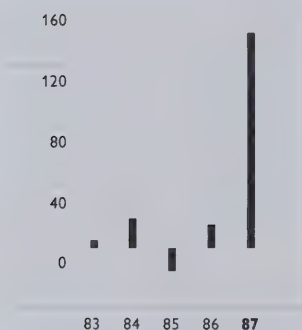
During 1987, a \$7 million conversion of a cracking heater to allow vacuum gas oil (VGO) to be used as a petrochemical feedstock completed its first full year in operation. Previously, this VGO could only be sold as fuel or traded for other feedstocks. By increasing the value of VGO, this conversion adds between \$5 million and \$10 million to operating profits each year.

To obtain crude oil from the international market, the division became a partner in a pipeline connection project called Chicap during the past year. Crude oil can now be transported economically to Sarnia from the U.S. Gulf Coast via a pipeline connection near Chicago. This increases the division's ability to compete with Gulf Coast operators and provides an important supply alternative to crude oil sourced from Western Canada.

During the past year, the division concluded sales agreements with Shell Canada Limited and Suncor Inc. to upgrade the value of its intermediate streams of petrochemical products. Through these mutually beneficial arrangements, the division exchanges product streams that have greater value in the operations of the receiving company. The division produced more ethylene during 1987 than originally planned and expects to make further production increases during 1988. The division is increasing sales of its products to new customers near Sarnia, thereby reducing distribution costs and improving netbacks.

**Outlook:** A period of good financial performance is expected from the division during the next few years. An economic slowdown would reduce earnings, but industry dynamics and the significant improvements made to plant operations will minimize the effects of business cycles on the division. Global demand for

**Petrochemicals and Polymers  
Contribution from Operations**  
(millions of dollars)





ethylene and styrene is growing faster than new capacity is being added. With the long lead times and massive investments required to build petrochemical complexes, it will be three to five years before significant new capacity comes on stream.

The division will continue with programs designed to improve its margins. Capital spending is projected to be about an average of \$25 million each year within the division.

### **Polymer Division**

The Polymer division is one of the world's largest producers of synthetic rubber and a major North American plastics manufacturer. The division has operations that manufacture rubber, latex, plastics and specialty products. It uses raw material feedstocks produced by the Basic Petrochemical division and purchased from other refiners.

In late 1987, an agreement was reached to sell to BASF AG of West Germany all the assets of the latex business. Completion of this sale for about \$500 million is expected before the end of May 1988.

During the past year, prices for many raw materials used by the Polymer division increased and resulted in higher manufacturing costs. This led to a moderate squeeze on margins during the early part of the year and lower operating income for the rubber and latex operations. The plastics business, however, reported strong operating earnings as a result of the significant increase in prices for polystyrene resin.

The Polymer division had 1987 sales of \$1.8 billion, up from \$1.4 billion. (These include sales by the latex unit of \$369 million, compared with \$323 million in 1986.) Operating contribution from the Polymer division totalled \$176.5 million during the past year, up from \$170.1 million in the year-earlier period.

Within the Polymer division, emphasis is being placed on products that have higher added value. A strategic move away from commodity products toward those demanding greater technological and global marketing expertise is resulting in improved performance and promises greater profit potential in the future. The Polymer division intends to continue this emphasis in its rubber and plastics operations where its technological expertise, marketing capabilities and efficient manufacturing operations represent the key assets required for the continued success of this strategy.

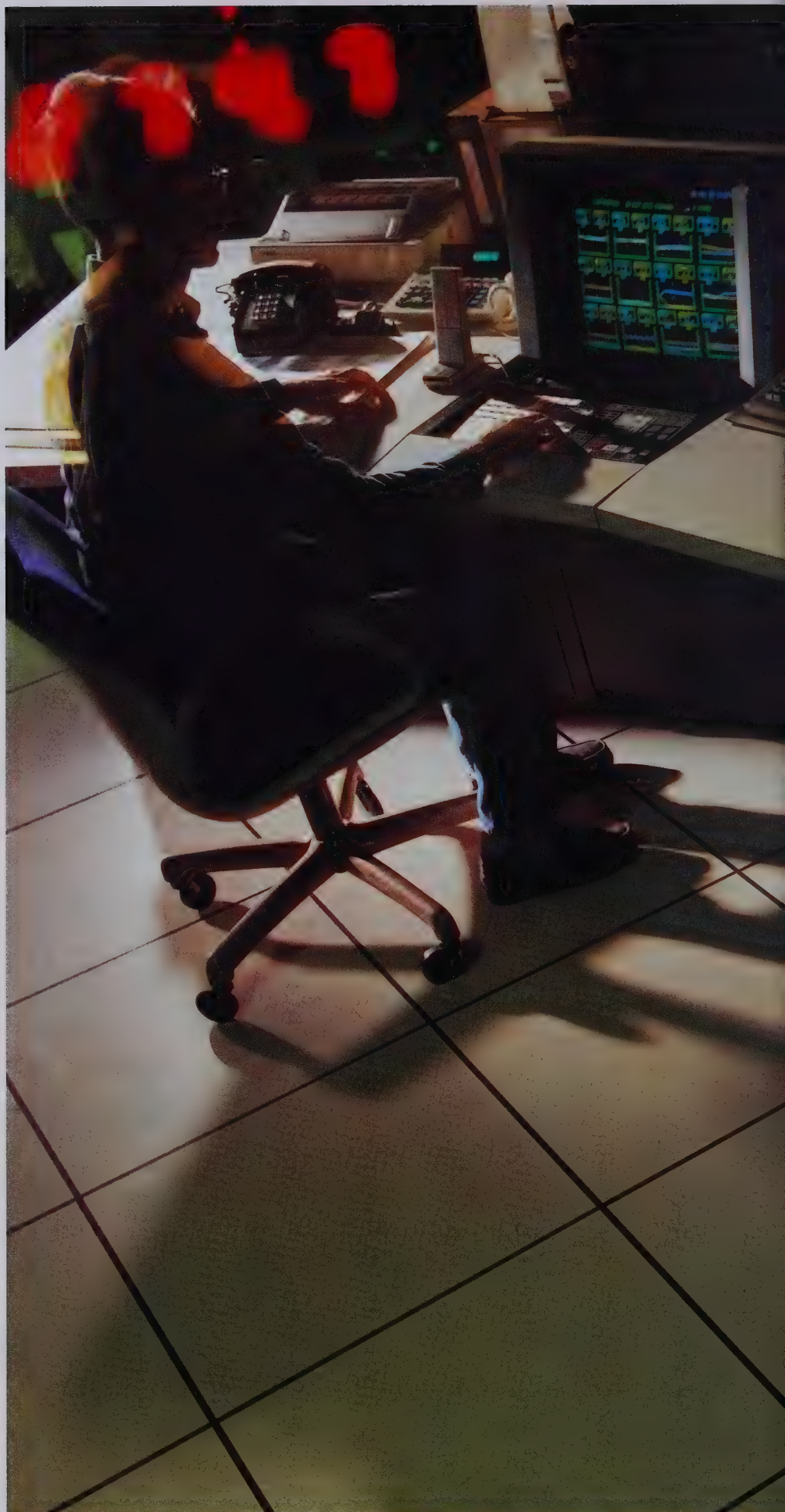


Rubber is manufactured in bales at the Polymer division's plant in Orange, Texas.

### *Rubber Operations*

The results from rubber operation during 1987 were the second highest ever, despite the margin squeeze that occurred early during 1987 from higher feedstock costs. Total sales volume of 422,000 tonnes was up slightly from 1986 despite the closing of a plant manufacturing general purpose styrene-butadiene rubber, a commodity product, that reduced annual sales volume by 25,000 tonnes. Operating contribution of \$85 million was 22% lower than 1986. Revenue of \$850 million was the same as 1986.

**THE IMPROVEMENT IN  
1987 PERFORMANCE  
RESULTED FROM  
HIGHER PRICES AND  
DEMAND FOR PRODUCTS  
PRODUCED BY THE  
BASIC PETROCHEMICAL  
DIVISION.**



A computer control room at the Polymer division's plant in Orange, Texas provides plant operators with instantaneous control of operations.





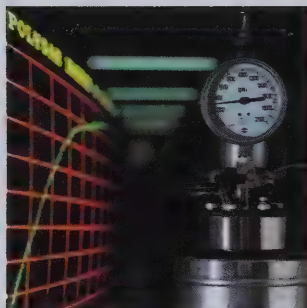
**Products:** Plants in Europe, the United States and in Canada produce a variety of synthetic rubber products sold around the world. About 75% are used in the automotive sector, about 80% of that amount in tires. Although rubber operations produce commodity products, its emphasis in recent years has been to increase sales of its specialty products. Specialty rubber types include nitrile, used in auto parts requiring oil resistance such as seals and hoses; butyl, used mostly for liners in high performance tubeless radial tires and tire tubes; ethylene-propylene, used in weather-resistant products such as roofing and weather strip-ping; and special grades of polybutadiene used as plastics additives.

Because of more demanding technical requirements for specialty rubbers, they generally command higher prices and are more profitable. A typical gross margin for a specialty rubber can be as much as twice that of a commodity. For example, the average selling price for commodity rubbers during 1987 was less than \$1,000 per tonne, compared with more than \$2,000 per tonne for the division's range of specialty rubber products.

The effect of rising raw material costs during 1987 was felt throughout rubber operations but the greatest impact occurred in Europe, where demand was strong and the higher material costs could not be passed quickly onto customers, particularly for butyl rubber. The impact of higher material costs was made worse by the fact that selling prices, as expressed in local currencies, had to be cut several times during 1987 to reflect the relative decline in value of North American currencies. However, the rubber business was successful in restoring margins by year end, producing an operating performance during the fourth quarter that exceeded the year-earlier period.

The rubber operations are placing strong emphasis on effective global marketing and consistent technological improvements to increase the sale of specialty rubbers. Since 1982, the rubber business has increased sales of butyl rubber by two-thirds and its world market share by one-third after introducing bromobutyl rubber for tubeless radial tires and strengthening its marketing effort in the Asia-Pacific region.

Sales of nitrile rubber have increased steadily and world market share has been maintained at about 20%. Sales of ethylene propylene rubber have also increased significantly, with volume doubling from 1982 when this business was entered through an acquisition. Early in 1988, a plant expansion at Orange, Texas will add new capacity to meet expected market growth.



A small-scale reactor and computer screen in a laboratory at the Polymer division's Sarnia research facilities emphasizes the sophisticated nature of polymer research.

**Research and Development:** Research and development is adding new polymer products. TORNAC rubber is a new type of nitrile rubber with heat and oil-resistant properties that are in increasing demand by industry, particularly within the auto sector. The development of TORNAC rubber is the result of an invention of a new process technology by Polysar with Ontario's University of Waterloo. This invention won the a 1987 Canada Gold Award For Business Excellence. In 1987, construction started on a plant in Orange, Texas to produce TORNAC rubber in commercial quantities. Annual capacity will be 1,600 tonnes when production commences in late 1988. TORNAC rubber will sell for \$15 per pound, 10 to 15 times that of more conventional oil-resistant rubbers.

Last year, \$21 million was spent on research and development activities. Research is aimed at creating a second generation butyl rubber, developing a new family of polybutadiene rubber and introducing ethylene-propylene rubber into new applications.



*Outlook:* The automotive sector, particularly the tire market, is a significant factor in the continuing growth of the rubber business. The replacement market, more than original equipment sales, is the key determinant of this market. During early 1988, the tire market remained strong, and with margins stabilizing and increased emphasis on marketing specialty rubber products, performance should improve over 1987.

There are many opportunities for growth within the rubber industry. Gradual gains will be recorded in sales volume and revenues each year, but emphasis on specialty rubbers should result in greater increases in operating profit over the next five years.

#### *Plastics Operations*

The Polymer division is a major supplier of polystyrene resin in North America and is adding production of other higher value-added plastics. During 1987, sales increased to 334,000 tonnes from 200,000 tonnes in 1986. Revenue more than doubled to \$468 million and operating contribution during the year increased to \$50 million, up from \$7 million in 1986.

The largest contributor to the volume and revenue increases was the former U.S. polystyrene operations of the Monsanto Company, acquired in September 1986. This acquisition more than doubled capacity to 390,000 tonnes and provided new technology and markets at a relatively low cost, making the Polymer division into one of the top three suppliers of polystyrene resin in North America with a 15% market share during 1987.

The outlook for polystyrene is positive as a result of industry rationalization that has led to capacity in North America growing more slowly than demand. Building on its base in polystyrene, an effort is underway to move into other, more technically demanding and profitable plastics. Opportunities are being pursued to market products with greater strength than existing rigid plastics, as well as developing degradable or recyclable products to reduce the environmental impact from the increased use of plastic packaging.

During the year, Richardson Polymer Corp., a Connecticut-based performance plastic manufacturer with annual sales of approximately \$24 million, was acquired. Richardson specializes in tough, transparent plastics for household, automotive and medical uses. Richardson is planning to place the new ZYLAR resin into commercial production in 1988. ZYLAR resin is a clear impact-resistant plastic that withstands oils and fats, making it suitable for appliance and packaging applications.



During 1987, the Polymer division purchased Richardson Polymer Corporation in Madison, Conn., which is placing into commercial production its new ZYLAR resin.

#### *Specialty Products Operations*

Specialty products focuses on smaller product lines. It draws on technical and manufacturing capabilities throughout the Polymer division to develop products that meet smaller but well-identified market needs. This business comprises several smaller operations that could make a large contribution to future results. Its emphasis is on technically specialized, high-margin products, including silicone, custom rubber compounding, medical sheets used for casts and splints, and sealants and adhesives. During 1987, sales were \$70 million, a 16% increase over 1986. Because it works closely with customers, this business is able to explore new areas of opportunity that could provide significant growth.

The Energy division comprises Canterra Energy Ltd., and the U.S. oil, natural gas, sulphur and coal operations owned by Polysar Limited. During early 1988, the Corporation announced that it would dividend to its shareholders 49% of the common shares of Canterra, which explores for, produces and markets conventional crude oil, natural gas and sulphur in Western Canada.

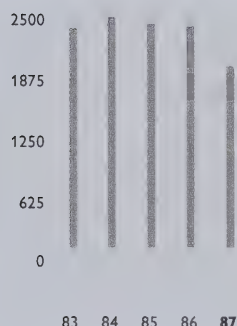
Although weak sulphur and natural gas markets contributed to a negative performance in 1987, Canterra had a number of positive accomplishments, including replacing all of its 1987 Canadian production of crude oil, gas liquids and natural gas on an oil equivalent basis through its exploration and enhanced recovery programs. In fact, the replacement of 110% of the company's total 1987 liquid production through exploration efforts was the best annual performance since Canterra was formed. Production operations during the past year were highlighted by significant reductions in operating costs and the start-up of an innovative plant to recover contaminated sulphur.

The company also reduced its long-term debt by \$400 million. Approximately \$100 million of the decrease in long-term debt during the past year was attributable to a strengthening of the Canadian dollar against the U.S. dollar. Other factors contributing to the significant debt reduction included a \$132 million capital consideration in payment for Canterra's petroleum sulphur and coal operations in the United States, a \$30 million issue of flow-through shares and the sale of the company's one-third interest in the Rainbow Pipe Line Company Ltd. that resulted in a non-recurring gain of \$12.5 million. The lower debt levels and somewhat reduced interest rates resulted in interest payments during the year that were 12% lower than 1986.

The Energy division recorded free cash flow from operations during 1987 of \$120.2 million compared with a restated free cash flow of \$176.4 million for 1986. This decrease was the result of a 36% drop in the price received for sulphur. Natural gas revenues were down 13%, the result of a 27% decrease in the price of natural gas.

The Energy division lost \$3.4 million during 1987. Non-recurring items and the results of non-consolidated subsidiaries produced profit of \$14.4 million; excluding these items, the operating loss for the year was \$17.8 million, compared with a restated loss from operations of \$10.7 million for 1986.

**Energy  
Long-Term Debt**  
(millions of dollars)



**Reserves and Exploration:** Reserve additions amounted to 2.2 million cubic metres of oil and liquids or 147% of 1987 production and 1.6 billion cubic metres of natural gas or 85% of production. These reserves do not include Canterra's substantial resources in the Canadian frontier nor its heavy oil and oil sands holdings in Western Canada. Sulphur additions and revisions were 75% of Canterra's sales during the year.

As a result of lower drilling, seismic and acquisition costs, as well as the success of higher-quality exploration projects, finding costs from exploration were reduced from a restated \$6 per barrel to \$2.72 based on the usual industry conversion of 10,000 cubic feet (10 mcf) of natural gas per barrel of oil but not including any sulphur additions.

The 1987 exploration programs were focused in Western Canada, principally Alberta, because of the continuing attractiveness of hydrocarbon potential and economic returns. Exploration activity was concentrated in the Rainbow Lake, Shekille and Fire areas of northern Alberta; Slave, Pouce Coupe, Sundown and Boundary Lake of the Peace River area; and in the Caroline and Garrington areas of west central Alberta.

Successful drilling in the Caroline area contributed 450 million cubic metres of gas reserves, 560,000 tonnes of sulphur and over 880,000 cubic metres of liquids. Canterra's lands in the Caroline area have not been fully evaluated and additional reserves may be added in 1988 as further development of this giant discovery continues.



Canterra pursues a strategy of very selective exploration in the Canadian frontier. During 1987, the company participated in Terra-Nova H-99 on the Grand Banks. This step-out well from the main discovery has proved to be the best reservoir drilled to date at Terra Nova and has resulted in doubling Canterra's established resources in this developing oil field.

*Production and Marketing:* During 1987, crude oil and liquids production before royalty was down 5% from 1986, largely due to pipeline transportation constraints during the first half of the year and the decline of the productive capacity of some of the company's older fields. During 1987, the Energy division produced and sold an average of 4.3 million cubic metres per day of crude oil and natural gas liquids before royalty. Natural gas volumes produced and sold during the year averaged 5.4 million cubic metres per day before royalty, up 2% from 1986.

Canterra restructured the majority of its Canadian crude oil sales, so that essentially all its production was marketed to Canadian refiners at their posted prices by year end. The Canadian refinery market was the premium market for western Canadian crude oil during the past year.

For natural gas, about 90% of the division's sales were delivered to traditional buyers under long-term contracts. During 1987, about 65% of commitments to purchase natural gas under these contracts were realized, compared with 59% during 1986. The Canadian natural gas industry significantly increased its export volumes during 1987. The market in the United States has started to tighten but transportation access remains the major impediment to further short-term increases in export volumes.

The division is actively pursuing direct natural gas sales in Canada and the United States. During 1987, it was successful in negotiating two long-term sales contracts into the United States and continued to supply the Basic Petrochemical division in Sarnia, Ontario with average daily volumes of 240,000 cubic metres.

Development plans continue for processing the division's newly discovered reserves in the Caroline area. Eight wells, in which the division has a working interest in two, have been drilled to outline this new discovery. The division's Ram River plant, less than 60 km from the discovery, is being considered for the processing of the wet-sour gas. Production from Caroline is expected to occur in 1990 or 1991.



Canterra's Ram River natural gas plant at dawn.

*Sulphur:* Global sulphur markets, which began to weaken in mid 1985, suffered a serious erosion in prices during 1987. Reduced demand in North America, Western Europe and, to a lesser extent, North Africa contributed to this price weakness. However, sulphur prices have bottomed and it appears they will firm during 1988.

The division's sales volumes were reduced from 1.7 million tonnes in 1986 to 1.6 million tonnes in 1987 as the share of Canadian offshore sulphur sales declined from 27% to 24%. The company's average selling price in 1987 was \$102 per tonne (U.S.) FOB Vancouver, down from \$135 per tonne (U.S.) in 1986.

One recent innovative project – the Ram River contaminated sulphur recovery unit – began operation during the year at design capacity. This \$4 million facility, which uses a patented design developed by Canterra, will allow the recovery of high purity sulphur from the dirt-contaminated basepads of sulphur storage blocks.

The plant can reclaim 300 tonnes per day and produce 99.6% pure sulphur. The Ram River plant is the site of approximately one-third of Alberta's base pad sulphur. The division is now contracting to process contaminated sulphur for others, earning both royalties, revenues and profits for this effort.

With 17% of the world's above ground sulphur inventories, the division has flexibility to increase sales when markets and prices are strong.

THE ENERGY DIVISION  
HAD AN EXCELLENT  
YEAR IN EXPANDING ITS  
ASSET BASE THROUGH  
SUCCESSFUL EXPLORA-  
TION PROGRAMS AND  
ENHANCED RECOVERY  
EFFORTS.

Canterra's Ram River natural gas plant is the site of the company's most recent innovative project – a contaminated sulphur recovery unit.







**Overview**

The Corporation's major objective is to maximize value for its common shareholders by concentrating on operating excellence and global competitiveness for its operations in petroleum, sulphur, petrochemicals and polymers. The past year marked a successful transition of the Corporation from a management holding company to an operating entity.

Some of the achievements in 1987 included:

- completing the sale of the remaining interest in CDC Life Sciences Inc. for \$169.2 million for a net gain of \$92.7 million;
- selling the \$270.8 million Falconbridge debentures for a net gain of \$30.4 million;
- reaching agreement to sell the Latex division for \$500 million with an estimated net gain of \$275 million to be recorded in 1988;
- eliminating the entire Third Preferred share issue of Polysar Limited, totalling \$181 million, at an out-of-pocket cash cost of \$84 million;
- settling litigation with Ontario Hydro for \$150 million and a net gain of \$18 million;
- disposing of AES Data Inc. at its carrying value;
- selling by public offering a \$30 million flow-through common share issue to finance oil and gas exploration;
- selling by public offering \$60.8 million in common shares; and
- converting Class B Preferred shares into 8.4 million common shares.

**Operations**

For the year ended December 31, 1987, revenue in the Energy division was down due to lower sulphur prices but this decrease was more than offset by higher revenue from petrochemicals and polymers.

*Revenue*

(millions)

| Year ended December 31      | 1987             | 1986             |
|-----------------------------|------------------|------------------|
| Energy                      | \$ 453.2         | \$ 557.1         |
| Petrochemicals and polymers | 2,464.0          | 2,047.6          |
| Eliminations                | (48.7)           | —                |
|                             | <b>\$2,868.5</b> | <b>\$2,604.7</b> |

Income from operations for 1987 was \$119.3 million, up from a loss of \$18.7 million in 1986 before the write-down of properties in that year of \$218.0 million. Net income for 1987 totalled \$227.5 million, taking into account net gains of \$107.5 million from non-recurring items, compared with a net loss of \$296.8 in 1986.

*Contribution*

(millions)

| Year ended December 31                        | 1987            | 1986              |
|-----------------------------------------------|-----------------|-------------------|
| Energy                                        |                 |                   |
| Operations before write-downs                 | \$ (17.8)       | \$ (10.7)         |
| Write-down of property                        | —               | (218.0)           |
| Petrochemicals and polymers                   | 141.3           | 13.0              |
| Corporate                                     | (4.2)           | (21.0)            |
| Income (loss) from operations                 | 119.3           | (236.7)           |
| Equity in earnings of discontinued operations | 0.7             | (70.9)            |
| Non-recurring items                           | 107.5           | 10.8              |
| Net income (loss)                             | <b>\$ 227.5</b> | <b>\$ (296.8)</b> |

After payment of preferred dividends, the income to common shareholders from operations was \$69.9 million or \$1.33 per common share compared with a loss of \$293.7 million or \$7.73 per common share in 1986. Net income to common shareholders in 1987 was \$178.1 million or \$3.39 per share compared to a net loss in 1986 of \$353.8 million or \$9.31 per share.



In energy, 1987 operations were hurt by a significant drop in sulphur prices which reduced revenue from sulphur sales by over 33% from 1986 levels with volume accounting for an additional 7% drop. Oil and natural gas liquids showed a 9.7% improvement in total revenue with higher prices offsetting a slight decline in volumes. Natural gas prices dropped by more than 25% in 1987 compared with the average price received in 1986 but the volume of gas shipped in 1987 was 2% higher than in 1986 with a noticeable improvement in the latter part of the year. Petroleum and sulphur operating costs were \$158.7 million, down from \$179.5 million in 1986 as a result of lower sales volumes and cost-cutting actions initiated in 1986 in response to business conditions.

Petrochemical and polymer operations achieved record results in 1987. The basic petrochemical operations, which include the Corunna facility, experienced higher profit margins and lower operating costs. Substantial price increases resulted in improved margins for most basic and intermediate petrochemical products, but affected rubber and latex businesses negatively as they had difficulty early in 1987 in passing on the increased feedstock costs to their customers. As a result of the acquisition of assets in the United States during 1986, plastic operations showed a striking improvement in return in 1987.

### Non-recurring Items

During 1987 the Corporation continued to divest itself of non-strategic assets, disposing of a number of holdings with substantial gains, while providing for potential losses on the eventual disposition of other remaining holdings.

#### Non-recurring items (millions)

| Year ended December 31                                     | 1987    | 1986    |
|------------------------------------------------------------|---------|---------|
| Gain on sale of investments                                |         |         |
| CDC Life Sciences                                          | \$ 92.7 | \$ 67.9 |
| Falconbridge debentures                                    | 31.0    | —       |
| Other                                                      | 28.4    | 9.9     |
|                                                            | 152.1   | 77.8    |
| Provision for decline in value                             |         |         |
| CDC Data Systems                                           | (19.0)  | (45.9)  |
| Mining assets                                              | (20.0)  | (21.1)  |
| Other                                                      | (15.5)  | —       |
|                                                            | (54.5)  | (67.0)  |
| Settlement of litigation less<br>net loss on debt payments | 9.9     | —       |
|                                                            | \$107.5 | \$ 10.8 |

The provision for the decline in value of CDC Data reflects the write-down of the Corporation's holding in Savin Corporation to amounts received or expected to be received from a restructuring of Savin during 1988. The remaining interest in the business is carried at no cost.

The provision for mining assets reflects a possible tax liability arising from an acquisition made in 1981. In recognition of the Corporation's intent to discontinue funding the research activities of Allelix Inc. beyond its contractual requirement, full provision has been made for payments to be made in 1988. These payments are not considered to add value to the Corporation's investment in Allelix.

### Cash Flow

Cash flow from petrochemical and polymer operations improved dramatically in 1987. Cash flow before financing costs totalled \$426.5 million compared with \$239.3 million in 1986. Cash flow from energy, however, dropped from \$378.6 million in 1986 to \$295.3 million largely as a result of lower sulphur prices.

Financing costs declined largely due to the repayment of more than \$1 billion of long-term debt during 1987 and the redemption of preferred shares by Polysar Limited and the conversion of the Corporation's Class B Preferred shares.

In 1987, financing costs of \$335.1 million absorbed 47% of the available cash flow before financing costs, compared with 70% of the available cash flow in 1986. Capital expenditures were \$106.8 million in 1987, compared with \$193.6 million in 1986. As a percentage of the free cash flow from operations, capital expenditures were 28% in 1987; in 1986, capital expenditures exceeded free cash flow.

*Cash Flow*  
(millions)

|                                | Cash flow<br>from<br>operations<br>before<br>financing costs | Financing<br>costs | Free<br>cash flow<br>from<br>operations | Capital<br>expenditures |
|--------------------------------|--------------------------------------------------------------|--------------------|-----------------------------------------|-------------------------|
| <b>1987</b>                    |                                                              |                    |                                         |                         |
| Energy                         | <b>\$295.3</b>                                               | <b>\$175.1</b>     | <b>\$120.2</b>                          | <b>\$ 36.0</b>          |
| Petrochemicals and<br>polymers | <b>426.5</b>                                                 | <b>125.0</b>       | <b>301.5</b>                            | <b>70.6</b>             |
| Corporate                      | <b>(8.7)</b>                                                 | <b>35.0</b>        | <b>(43.7)</b>                           | <b>0.2</b>              |
|                                | <b>\$713.1</b>                                               | <b>\$335.1</b>     | <b>\$378.0</b>                          | <b>\$106.8</b>          |
| <b>1986</b>                    |                                                              |                    |                                         |                         |
| Energy                         | \$378.6                                                      | \$202.2            | \$176.4                                 | \$108.8                 |
| Petrochemicals and<br>polymers | 239.3                                                        | 149.5              | 89.8                                    | 84.6                    |
| Corporate                      | (3.4)                                                        | 76.5               | (79.9)                                  | 0.2                     |
|                                | <b>\$614.5</b>                                               | <b>\$428.2</b>     | <b>\$186.3</b>                          | <b>\$193.6</b>          |

**Capitalization**

Coupon-bearing capital was reduced by \$1.4 billion during 1987 as a result of asset dispositions and repayment of debt, redemption of the Third Preferred shares of Polysar Limited and the conversion of the Corporation's Class B Preferred Shares. Coupon-bearing capital represented 83% of total capitalization at the end of 1987 compared to 93% at the end of 1986.

Common shares were issued for an aggregate consideration of \$205.6 million, increasing the common share capital to \$586.8 million.

*Capitalization*  
(millions)

| As at December 31                             | <b>1987</b>    |            | <b>1986</b> |     |
|-----------------------------------------------|----------------|------------|-------------|-----|
|                                               | \$             | %          | \$          | %   |
| <b>Long-term debt</b>                         |                |            |             |     |
| Energy                                        | <b>1,875.7</b> |            | 2,278.3     |     |
| Petrochemicals and<br>polymers                | <b>811.0</b>   |            | 952.2       |     |
| Corporate                                     | <b>81.8</b>    |            | 625.6       |     |
|                                               | <b>2,768.5</b> | <b>63</b>  | 3,856.1     | 71  |
| Minority interest                             | <b>268.9</b>   | <b>6</b>   | 495.3       | 9   |
| <b>Preferred equity</b>                       |                |            |             |     |
| 1983 Senior Preferred                         | <b>120.5</b>   |            | 125.0       |     |
| 1980 Preferred                                | <b>300.0</b>   |            | 300.0       |     |
| 1985 Preferred                                | <b>208.0</b>   |            | 208.0       |     |
| B Preferred                                   | <b>—</b>       |            | 88.2        |     |
|                                               | <b>628.5</b>   | <b>14</b>  | 721.2       | 13  |
| <b>Coupon-bearing capital</b>                 | <b>3,665.9</b> | <b>83</b>  | 5,072.6     | 93  |
| <b>Common stock and<br/>retained earnings</b> | <b>765.5</b>   | <b>17</b>  | 383.3       | 7   |
| <b>Total capital employed</b>                 | <b>4,431.4</b> | <b>100</b> | 5,455.9     | 100 |

**Sensitivities**

The Corporation's financial performance is sensitive to a number of economic and business factors which influence interest rates and the prices received (and paid) for the products it manufactures and uses as feedstocks. With a large amount of the coupon-bearing capital being at floating interest rates, a change in interest rates impacts earnings and cash flow significantly. The approximate impact on current earnings and cash flow based on recent production levels is set out in the following table.



| Variable                            | As at<br>December<br>31, 1987 | Average<br>1987 | Change | Approximate<br>impact on<br>free cash<br>flow | Approximate<br>impact on<br>earnings |
|-------------------------------------|-------------------------------|-----------------|--------|-----------------------------------------------|--------------------------------------|
|                                     |                               |                 |        | (millions of Canadian dollars)                |                                      |
| Interest rates <sup>1</sup>         | 8.57%                         | 8.22%           | 1%     | 18                                            | 11                                   |
| Prices <sup>2</sup>                 |                               |                 |        |                                               |                                      |
| Oil(Cdn.\$/bbl) <sup>3</sup>        | 21.17                         | 23.12           | \$ 1   | 7                                             | 5                                    |
| Gas(Cdn.\$/mcf) <sup>3</sup>        | 1.81                          | 1.72            | 10¢    | 6                                             | 4                                    |
| Sulphur(Cdn.\$/tonne) <sup>3</sup>  | 86.00                         | 91.44           | \$10   | 11                                            | 8                                    |
| Ethylene(Cdn.\$/lb) <sup>4</sup>    | 0.25                          | 0.20            | 1¢     | 7                                             | 4                                    |
| Propylene(Cdn.\$/lb) <sup>4</sup>   | 0.23                          | 0.19            | 1¢     | 7                                             | 4                                    |
| Styrene(Cdn.\$/lb) <sup>4</sup>     | 0.52                          | 0.50            | 1¢     | 4                                             | 3                                    |
| Polystyrene(Cdn.\$/lb) <sup>4</sup> | 0.74                          | 0.64            | 1¢     | 5                                             | 3                                    |
| Benzene(Cdn.\$/lb) <sup>4</sup>     | 0.17                          | 0.23            | 1¢     | (5)                                           | (3)                                  |

<sup>1</sup> Average of interest rates paid on consolidated indebtedness. At December 31, 1987, the 90 day London Interbank Offered Rate was 7.44%, the Canadian Prime Rate was 9.75% and the U.S. Base Rate was 9.00%.

<sup>2</sup> These products are sold in markets in which prices are generally denominated in U.S. dollars. This table reflects prices received.

<sup>3</sup> Reflects the impact on the Energy Division only. The Basic Petrochemical division is a large buyer of natural gas, gas condensates and oil.

<sup>4</sup> The approximate impact on free cash flow and earnings of changes in petrochemical prices is estimated on the basis of anticipated production volumes net of internal requirements and assumes no change in the related feedstock costs.

### Restructuring Plan

On February 9, 1988, the Board of Directors approved a comprehensive restructuring plan to provide significantly increased value for all common shareholders. Pursuant to the plan, the Corporation intends to distribute to the common shareholders cash and securities with an estimated aggregate value in excess of \$900 million (assuming the full conversion of the 1980 Preferred shares) with the shareholders continuing to own their common shares after the distribution.

The estimated value of the distribution plus the estimated trading value of the common shares after the distribution is expected to exceed the trading value of the common shares prior to the distributions.

The plan is to provide common shareholders with securities and cash in two distributions.

The first distribution is payable as a dividend on April 29, 1988 to common shareholders of record on April 15, 1988 of:

- (1) 49% of the common shares of Canterra Energy Ltd. which are intended to be listed on Canadian stock exchanges.
- (2) \$130 million of Guaranteed Floating Rate notes bearing interest at a floating rate equivalent to 90 day Bankers' Acceptances plus 1.5% and maturing on May 15, 1993.

The second distribution, if made by way of a reduction in capital, is conditional upon shareholder approval with a meeting called for April 29, 1988 for that purpose. The second distribution will be made as soon as practicable after the closing of the sale of the latex business and will comprise:

- (1) \$500 million in Deferred Preferred shares retractable at the option of the holder on or after May 31, 1993 at the full face amount of \$20 per share. The retraction privilege is in lieu of periodic dividend payments. The shares will be redeemable at the option of the Corporation at a price commencing at \$11.75 per share on June 1, 1988 and increasing by approximately 6% every six months thereafter reaching \$20.00 per share on December 1, 1992. Application will be made to list the shares on Canadian stock exchanges.
- (2) A cash payment of up to \$370 million, which may be reduced by a maximum of \$309 million if required to pay for the redemption of the Corporation's 1980 Preferred shares. The 1980 Preferred shares have been called for redemption on March 14, 1988 unless the holder opts to convert to common shares prior to March 9, 1988.

The second distribution may be made by way of a dividend if shareholders do not approve the reduction of capital of the Corporation.

As part of the plan, holders of Canterra's exchangeable subordinated debentures will be asked to substitute a conversion feature into common shares of Canterra for the existing exchange right into common shares of the Corporation.

The plan is more fully set out in an information memorandum which is available from the Corporation.

## SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of the significant accounting policies of Polysar Energy & Chemical Corporation (the "Corporation") (formerly known as Canada Development Corporation) is presented to assist the reader of the financial statements. These accounting policies are in conformity with accounting principles generally accepted in Canada which are also in conformity with the historical cost accounting standards of the International Accounting Standards Committee.

### *Principles of Consolidation*

The consolidated financial statements incorporate the financial position, operating results and changes in financial position of the Corporation and its subsidiary companies, Polysar Limited and Canterra Energy Ltd. and their subsidiaries, except for the mining subsidiaries which are carried on an equity basis as it is the Corporation's intention to dispose of these subsidiaries.

Canterra Energy Ltd. conducts substantially all of its oil, natural gas and sulphur exploration and production activities on a joint venture basis and the accounts reflect the Corporation's proportionate interest in such activities.

The Corporation accounts for its investments in former subsidiaries and companies in which it has significant influence on an equity basis. Other long-term investments are accounted for by the cost method.

### *Foreign Currency Translation*

The results of integrated foreign subsidiaries are translated using the temporal method. Under this method, monetary assets and monetary liabilities of foreign integrated operations of the Corporation are translated at the rate of exchange in effect at the balance sheet date. Non-monetary assets and liabilities are translated at the rates prevailing when they were acquired or incurred. Corresponding revenue and expenses, except depreciation, depletion and amortization, are translated at rates in effect during the year. Gains or losses resulting from this translation method are included in the consolidated statement of income. Gains or losses on long-term debt are deferred and amortized over the life of the particular debt.

Assets and liabilities of foreign operations deemed to be self-sustaining are translated at the rate of exchange in effect at the balance sheet date. Corresponding revenue and expenses are translated at rates in effect during the year. Gains or losses resulting from this translation method are deferred until there is a reduction in the net investment in the foreign operations.

### *Inventories*

Inventories are valued at the lower of cost and net realizable value.

### *Property, Plant and Equipment*

#### *(a) Cost*

Property, plant and equipment are recorded at cost. Fixed asset additions include related financing costs incurred during major plant construction.

The Corporation follows the full cost method of accounting prescribed by the Canadian Institute of Chartered Accountants' Guideline on Full Cost Accounting in the Oil and Gas Industry, whereby all costs of acquiring properties, exploring for and developing oil, natural gas and sulphur and related reserves are capitalized and accumulated in country-by-country cost centres. Such costs include land acquisition, drilling both productive and non-productive wells, overhead expenses and financing. The net carrying amount of each cost centre is limited to a ceiling test amount which is the estimated future net revenues from proved reserves (based on current prices and costs at the balance sheet date) plus unproved properties at carrying value. The aggregate of such estimated future net revenue for all cost centres is further reduced for recurring general and administrative costs, future financing costs and income taxes. Any costs carried on the balance sheet in excess of these ceiling test amounts are charged to earnings.

#### *(b) Depreciation, Depletion and Amortization*

Depreciation of plant and equipment is based on the estimated useful life of the assets from commencement of commercial production and is calculated on the straight-line method.

For oil, natural gas and sulphur operations, depletion and depreciation is provided on the unit of production method based on gross proved reserves in each cost centre as determined by the Corporation. Reserves are converted to equivalent units on the basis of approximate relative energy content. Costs of acquiring and evaluating unproved properties are excluded from the calculation of depletion and depreciation until it is determined that proved reserves are attributable to the properties or that impairment has occurred. Costs of acquiring and evaluating unproved properties in Western Canada and in the Canadian Frontier areas have been excluded from capitalized costs subject to depletion until determination of whether or not reserves have been proved or impairment has occurred. All dry hole costs are included in cost centres subject to depletion.

### *Pre-Production and Deferred Expenditures*

Expenditures incurred in connection with major new production facilities are deferred and amortized from commencement of production on the straight-line basis over a period generally not exceeding ten years.

### *Comparative Amounts*

The 1986 consolidated financial statements have been reclassified to conform to 1987 presentation.



# **CONSOLIDATED STATEMENT OF INCOME**

(millions)

Polysar Energy & Chemical  
Corporation

| Year ended December 31                                     | 1987             | 1986              |
|------------------------------------------------------------|------------------|-------------------|
| <b>Revenue</b>                                             | <b>\$2,868.5</b> | <b>\$2,604.7</b>  |
| <b>Expenses</b>                                            |                  |                   |
| Cost and expenses before the undernoted                    | <b>2,131.6</b>   | 1,979.0           |
| Depreciation, depletion and amortization                   | <b>280.0</b>     | 313.2             |
| Write-down of property, plant and<br>equipment             | <b>—</b>         | 304.7             |
| Interest on long-term debt (note 3)                        | <b>231.8</b>     | 312.2             |
| Other interest                                             | <b>12.4</b>      | 2.6               |
|                                                            | <b>2,655.8</b>   | 2,911.7           |
| Income (loss) before the following                         | <b>212.7</b>     | (307.0)           |
| Income taxes (note 10)                                     | <b>(76.2)</b>    | 80.9              |
| Minority interest                                          | <b>(17.2)</b>    | (10.6)            |
| Income (loss) from operations                              | <b>119.3</b>     | (236.7)           |
| Equity in earnings of discontinued<br>operations (note 11) | <b>0.7</b>       | (70.9)            |
| Non-recurring items (note 12)                              | <b>107.5</b>     | 10.8              |
| Net income (loss)                                          | <b>227.5</b>     | (296.8)           |
| Preferred share dividends                                  | <b>(49.4)</b>    | (57.0)            |
| Net income (loss) applicable to<br>common shares           | <b>\$ 178.1</b>  | <b>\$ (353.8)</b> |
| <b>Per common share (note 9)</b>                           |                  |                   |
| Income (loss) from operations                              | <b>\$ 1.33</b>   | <b>\$ (7.73)</b>  |
| Net income (loss)                                          | <b>\$ 3.39</b>   | <b>\$ (9.31)</b>  |

## **Auditors' Report**

To the Shareholders of Polysar Energy & Chemical Corporation

We have examined the consolidated balance sheet of Polysar Energy & Chemical Corporation as at December 31, 1987 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1987 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, after giving retroactive effect to the change in the method of accounting for foreign currency translation as explained in Note 1, on a basis consistent with that of the preceding year.

*Thorne Ernst & Whinney*

Toronto, Canada  
February 12, 1988  
(February 19, 1988 as to note 13)

Thorne Ernst & Whinney  
Chartered Accountants

**CONSOLIDATED  
BALANCE SHEET**

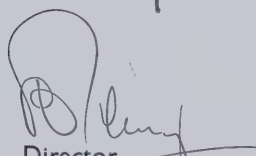
(millions)

Polysar Energy & Chemical  
Corporation

| December 31                                        | 1987      | 1986      |
|----------------------------------------------------|-----------|-----------|
| <b>Assets</b>                                      |           |           |
| <i>Current Assets</i>                              |           |           |
| Cash and short-term investments                    | \$ 54.1   | \$ 165.5  |
| Accounts receivable                                | 510.6     | 521.7     |
| Inventories (note 2)                               | 377.5     | 359.8     |
| Other current assets                               | 16.1      | 11.9      |
|                                                    | 958.3     | 1,058.9   |
| <i>Long-Term Investments (note 3)</i>              | 245.1     | 658.8     |
| <i>Property, Plant and Equipment (note 4)</i>      | 3,998.7   | 4,065.0   |
| <i>Other Assets (note 5)</i>                       | 243.8     | 458.9     |
|                                                    | \$5,445.9 | \$6,241.6 |
| <b>Liabilities</b>                                 |           |           |
| <i>Current Liabilities</i>                         |           |           |
| Short-term loans                                   | \$ 165.7  | \$ 162.1  |
| Accounts payable and accrued liabilities           | 452.8     | 368.8     |
| Long-term debt due within one year                 | 144.0     | 105.4     |
|                                                    | 762.5     | 636.3     |
| <i>Long-Term Debt (note 6)</i>                     | 2,624.5   | 3,750.7   |
| <i>Deferred Income Taxes</i>                       | 396.0     | 254.8     |
| <i>Interests of Minority Shareholders (note 7)</i> | 268.9     | 495.3     |
|                                                    | 4,051.9   | 5,137.1   |
| <b>Shareholders' Equity</b>                        |           |           |
| <i>Capital Stock (note 8 and 13)</i>               |           |           |
| Preferred                                          | 628.5     | 721.2     |
| Common                                             | 586.8     | 381.2     |
| <i>Retained Earnings</i>                           | 178.7     | 2.1       |
|                                                    | 1,394.0   | 1,104.5   |
|                                                    | \$5,445.9 | \$6,241.6 |

Approved on behalf of the Board

  
Director

  
Director



**CONSOLIDATED STATEMENT  
OF RETAINED EARNINGS**

(millions)

Polysar Energy & Chemical  
Corporation

| Year ended December 31                                                                  | 1987           | 1986     |
|-----------------------------------------------------------------------------------------|----------------|----------|
| <i>Retained earnings at beginning of year<br/>as previously reported</i>                | <b>\$ 60.1</b> | \$ 402.2 |
| Adjustment of prior years' translation<br>of foreign currency amounts (note 1)          | <b>(58.0)</b>  | (44.4)   |
| <i>As restated</i>                                                                      | <b>2.1</b>     | 357.8    |
| <i>Net Income (loss)</i>                                                                | <b>227.5</b>   | (296.8)  |
|                                                                                         | <b>229.6</b>   | 61.0     |
| Dividends on preferred shares                                                           | <b>49.4</b>    | 57.0     |
| Amortization of costs of preferred<br>share issues                                      | <b>1.4</b>     | 1.9      |
| Excess of cost over carrying value<br>of preferred shares purchased<br>for cancellation | <b>0.1</b>     | –        |
|                                                                                         | <b>50.9</b>    | 58.9     |
| <i>Retained earnings at end of year</i>                                                 | <b>\$178.7</b> | \$ 2.1   |

**CONSOLIDATED STATEMENT  
OF CHANGES IN FINANCIAL  
POSITION**

(millions)

Polysar Energy & Chemical  
Corporation

| Year ended December 31                                                | 1987            | 1986            |
|-----------------------------------------------------------------------|-----------------|-----------------|
| <b>Operations</b>                                                     |                 |                 |
| Income (loss) from operations                                         | \$ 119.3        | \$(236.7)       |
| Interest expense                                                      | 244.2           | 314.8           |
|                                                                       | 363.5           | 78.1            |
| Non-cash items:                                                       |                 |                 |
| Depreciation, depletion and amortization                              | 280.0           | 313.2           |
| Write-down of property, plant and equipment                           | -               | 304.7           |
| Deferred income taxes                                                 | 53.9            | (94.9)          |
| Equity in earnings                                                    | (1.5)           | 2.8             |
| Minority interest                                                     | 17.2            | 10.6            |
| <b>Cash flow before financing costs</b>                               | <b>713.1</b>    | <b>614.5</b>    |
| <b>Financing costs</b>                                                |                 |                 |
| Interest expense                                                      | 244.2           | 314.8           |
| Capitalized interest                                                  | 14.1            | 16.2            |
| Capitalized overhead costs                                            | 10.1            | 13.9            |
| Dividends on preferred shares                                         | 49.4            | 57.0            |
| Dividends to minority shareholders                                    | 17.3            | 26.3            |
|                                                                       | 335.1           | 428.2           |
| <b>Free cash flow</b>                                                 |                 |                 |
| Operations                                                            | 378.0           | 186.3           |
| Non-recurring items                                                   | 296.1           | 92.6            |
|                                                                       | 674.1           | 278.9           |
| <b>Equity financing</b>                                               |                 |                 |
| Issue of capital stock                                                | 205.6           | 28.7            |
| Reduction of preferred stock                                          | (92.7)          | (44.1)          |
| Net investment by minority interest                                   | (224.4)         | (79.6)          |
|                                                                       | (111.5)         | (95.0)          |
| <b>Cash generated for investment activities and repayment of debt</b> | <b>562.6</b>    | <b>183.9</b>    |
| <b>Investment activities</b>                                          |                 |                 |
| Additions to property, plant and equipment                            | 106.8           | 193.6           |
| Changes in working capital other than cash                            | (72.8)          | (244.4)         |
| Investment in non-consolidated subsidiaries and affiliates            | (385.3)         | (219.5)         |
| Additions to other assets                                             | (58.9)          | 56.8            |
|                                                                       | (410.2)         | (213.5)         |
| <b>Cash generated (used) during the year</b>                          | <b>\$ 972.8</b> | <b>\$ 397.4</b> |
| <b>Cash (applied to) funded by:</b>                                   |                 |                 |
| Short-term loans, net of cash                                         | \$ 114.9        | \$(239.9)       |
| Long-term debt                                                        | (1,087.7)       | (157.5)         |
|                                                                       | \$ (972.8)      | \$(397.4)       |



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1 Change in Accounting Policy

In 1987, the Corporation retroactively changed its method of accounting for U.S. dollar debt. Prior to the change, gains and losses on translation of U.S. dollar debt which was considered hedged by U.S. dollar revenue streams were deferred and included in the income statement when net repayments occurred. In 1987, the Corporation adopted the more widely accepted practice of deferring and amortizing unrealized exchange gains and losses over the term of the debt.

The effect of this accounting change is summarized below:

|                                               |          |
|-----------------------------------------------|----------|
| Decrease in opening 1986 retained earnings    | \$(44.4) |
| Decrease in 1986 earnings                     | (13.6)   |
| Increase in 1987 earnings                     | 14.9     |
| Net decrease in ending 1987 retained earnings | \$(43.1) |

### 2 Inventories

|                                    | 1987   |                | 1986    |         |
|------------------------------------|--------|----------------|---------|---------|
| (millions)                         | Energy | Petro-chemical | Total   | Total   |
| Finished goods                     | \$ -   | \$184.9        | \$184.9 | \$138.9 |
| Raw materials and work in progress | 43.7   | 113.5          | 157.2   | 183.9   |
| Operating and maintenance supplies | 4.8    | 30.6           | 35.4    | 37.0    |
|                                    | \$48.5 | \$329.0        | \$377.5 | \$359.8 |

### 3 Long-Term Investments

| (millions)                        | 1987    | 1986    |
|-----------------------------------|---------|---------|
| Falconbridge Limited              |         |         |
| Advances (note 6(iii))            | \$ 68.1 | \$ 83.9 |
| CDC Data Systems                  |         |         |
| Shares and advances               | 60.7    | 57.3    |
| Mining assets                     | 51.1    | 48.4    |
| Petrochemical                     | 29.1    | 47.6    |
| Falconbridge Limited              |         |         |
| Shares and convertible debentures | 0.1     | 338.8   |
| CDC Life Sciences Inc.            |         |         |
| Shares                            | -       | 32.0    |
| Other investments                 | 36.0    | 50.8    |
|                                   | \$245.1 | \$658.8 |

(i) Dispositions of Investments (notes 11 and 12)

In July 1987, the Corporation sold its remaining interest (5.5 million common shares) in CDC Life Sciences Inc. for net cash proceeds of \$167.1 million.

In April 1987, the Corporation sold its investment in \$270.8 million of Falconbridge Limited ("Falconbridge") convertible subordinated debentures for cash proceeds of \$311.4 million.

In August 1987, the Corporation sold its remaining investment in AES Data Inc. An additional investment of \$13.0 million was made pursuant to the sale resulting in a note receivable of \$29.5 million. No gain or loss was recorded on the sale.

During 1987, the Corporation disposed of its interest in various subsidiaries for cash proceeds of \$47.6 million.

## Polysar Energy & Chemical Corporation

(ii) Provisions for decline in value (note 12)

During 1987, the Corporation determined that its net investment in Savin Corp. exceeded its realizable value and accordingly was written down. The Corporation's investment in Hules Mexicanos S.A. was reclassified as non-strategic and written down to its net realizable value.

(iii) Interest income related to Falconbridge of \$13.0 million (1986, \$30.0 million) has been included as a reduction of interest on long-term debt in the consolidated statement of income.

### 4 Property, Plant and Equipment

|               | 1987             |              | 1986      |           |
|---------------|------------------|--------------|-----------|-----------|
| (millions)    | Accumulated Cost | Depreciation | Net       | Net       |
| Energy        | \$3,727.0        | \$1,090.1    | \$2,636.9 | \$2,690.6 |
| Petrochemical | 2,187.3          | 827.2        | 1,360.1   | 1,372.0   |
| Corporate     | 4.9              | 3.2          | 1.7       | 2.4       |
|               | \$5,919.2        | \$1,920.5    | \$3,998.7 | \$4,065.0 |

(i) Energy includes costs of unproved properties excluded from depletion as follows:

|                              | 1987                     |          | 1986    |          |
|------------------------------|--------------------------|----------|---------|----------|
| (millions)                   | Western Canada and Other | Frontier | Total   | Total    |
| Balance at beginning of year | \$209.6                  | \$94.5   | \$304.1 | \$ 654.0 |
| Acquisitions                 | 12.3                     | -        | 12.3    | 15.4     |
| Exploration                  | -                        | 2.6      | 2.6     | 12.0     |
| Capitalized financing costs  | 14.0                     | -        | 14.0    | 14.8     |
| Transfer to depletion base   |                          |          |         |          |
| Land and exploration         | (33.7)                   | (2.6)    | (36.3)  | (47.1)   |
| Impairment                   | -                        | -        | -       | (345.0)  |
| Balance at end of year       | \$202.2                  | \$94.5   | \$296.7 | \$ 304.1 |

Transferred costs are subject to depletion in subsequent years.

### 5 Other Assets

| (millions)                           | 1987    | 1986    |
|--------------------------------------|---------|---------|
| Deferred foreign exchange            | \$133.1 | \$269.7 |
| Pre-production and deferred expenses | 75.1    | 86.1    |
| Goodwill                             | 1.1     | 59.0    |
| Cost of long-term financings         | 19.0    | 28.1    |
| Long-term receivables                | 15.5    | 16.0    |
|                                      | \$243.8 | \$458.9 |

During the next five fiscal years, pre-production and deferred expenses and goodwill are expected to be amortized to income at the rate of \$14.8 million annually.

## 6 Long-Term Debt

| (millions)                                                                                 | 1987    | 1986    |
|--------------------------------------------------------------------------------------------|---------|---------|
| <i>Polysar Energy &amp; Chemical Corporation</i>                                           |         |         |
| Subordinated debentures, due 1990 through 1993 (United States dollars)                     | \$ 68.1 | \$ 83.9 |
| Floating rate syndicated loan, secured (United States dollars) repayable 1988 through 1990 | —       | 443.4   |
| 6.125% Notes, due 1990 (Swiss francs)                                                      | —       | 85.6    |
| 8.0% Notes, due 1992                                                                       | 13.7    | 12.7    |
|                                                                                            | 81.8    | 625.6   |
| <i>Canterra Energy Ltd.</i>                                                                |         |         |
| Floating rate syndicated loan, repayable 1988 through 1997 (United States dollars)         | 1,343.7 | 1,646.3 |
| Floating rate bank loans, due 1988 to 1992 (United States dollars)                         | 146.2   | 247.6   |
| 8.5% Exchangeable subordinated debentures, due 2000                                        | 150.0   | 150.0   |
| Floating rate bank loans, due 1990                                                         | —       | 9.9     |
| 5.625% Notes, due 1992 (Swiss francs)                                                      | 127.9   | 107.0   |
| 6.75% Bearer bonds, due 1992 (Deutsche marks)                                              | 65.1    | 69.1    |
| 10.25% Mortgage, due 1995                                                                  | 13.4    | 13.6    |
| Customer prepayments                                                                       | 29.4    | 34.6    |
| Other                                                                                      | —       | 0.2     |
|                                                                                            | 1,875.7 | 2,278.3 |

### *Polysar Limited*

#### Canadian Dollars

|                                                                                                                                                        |      |       |
|--------------------------------------------------------------------------------------------------------------------------------------------------------|------|-------|
| Floating rate multi-currency revolving credit facility, currently bearing interest at 9.41%, repayable 1994 and 1995                                   | 46.6 | 169.9 |
| Fixed rate multi-currency revolving credit facility, bearing interest at 12.58%, converting to floating rate in 1988 and 1990, repayable 1994 and 1995 | 69.3 | 66.5  |
| Floating rate term loan, currently bearing interest at 9.75%, repayable 1988 through 1991                                                              | 41.7 | 89.2  |
| Fixed rate term loans, bearing interest at 11.60%, converting to floating rate in 1992, repayable 1992 through 2001                                    | 15.0 | 15.0  |
| Sinking fund debentures, bearing interest at 9.0%, repayable 1991 through 1993                                                                         | 16.9 | 28.1  |

#### United States Dollars

|                                                                                                                               |       |       |
|-------------------------------------------------------------------------------------------------------------------------------|-------|-------|
| Floating rate revolving term credit facility, currently bearing interest at 9.05%, repayable 1992 through 1994                | 141.7 | —     |
| Floating rate revolving and term credit facilities, currently bearing interest at 8.54%, repayable 1988 through 1999          | 190.0 | 127.9 |
| Notes payable, currently bearing interest at an average rate of 6.60%, repayable 1988 through 2003                            | 13.2  | 14.9  |
| Floating rate multi-currency revolving and term credit facility, currently bearing interest at 6.81%, repayable 1994 and 1995 | 19.5  | 204.3 |
| 8.25% Debentures, due 1991                                                                                                    | 40.3  | 41.0  |

## Long-Term Debt (cont'd)

| (millions)                                                                                                              | 1987      | 1986      |
|-------------------------------------------------------------------------------------------------------------------------|-----------|-----------|
| <b>Other currencies</b>                                                                                                 |           |           |
| 9.375% Debentures, due 1993 (European Currency Units)                                                                   | 102.3     | 89.1      |
| Fixed and floating rate term loans, currently bearing interest at an average rate of 9.44%, repayable 1988 through 1999 | 91.1      | 86.5      |
| Other non-current liabilities                                                                                           | 23.4      | 19.8      |
|                                                                                                                         | 811.0     | 952.2     |
| Long-term debt at current rates of translation                                                                          | 2,768.5   | 3,856.1   |
| Less principal due within one year                                                                                      | 144.0     | 105.4     |
|                                                                                                                         | \$2,624.5 | \$3,750.7 |

(i) Canterra's floating rate syndicated loan bears interest at a rate of 3/4 of one percent over London Inter-Bank Offer Rate with provision for reduction in such rates by 1/8 of 1% in certain circumstances.

The loan agreement contains certain restrictive covenants. The primary covenants require Canterra to maintain a specified ratio of current assets to current liabilities at the end of each quarter, a specified fixed charge coverage calculated on an annual basis and a specified ratio of debt at each June 30 to the value of proved reserves on the preceding December 31.

(ii) On September 30, 1987, holders of Canterra's Convertible Subordinated Debenture approved an amendment to the Trust Indenture, enabling them to exchange each \$1,000 principal amount of Debentures for 39.216 common shares of the Corporation (being an exchange price of \$25.50 for each common share). This replaced the previous conversion privilege of 58.824 Canterra common shares for each \$1,000 principal amount (being an exchange price of \$17.00 for each Canterra common share).

(iii) The Corporation's subordinated debentures bear interest at the rate of 7.5% until March 31, 1989 and thereafter to maturity at the rate of 11%. Each U.S. \$100,000 principal amount of debentures carries the right to acquire silver until March 31, 1988 at the rate of 7,019 troy ounces of silver, and to March 31, 1989 at the rate of 6,755 troy ounces of silver, in each case for U.S. \$100,000. The right to acquire silver expires after March 31, 1989. The debentures are retractable at the option of the holder at the time and to the extent the right to acquire silver is exercised. The Corporation has contracted with Falconbridge to meet these obligations.

During the year, U.S. \$8.4 million of subordinated debentures were redeemed in exchange for U.S. \$8.4 million of the Corporation's advances to Falconbridge.

(iv) The Corporation has entered into interest rate exchange agreements which effectively convert the interest cost on \$306.5 million from floating rates to fixed rates for an average period of 5 years. At December 31, 1987 the average interest rate on the exchange agreements exceeded the floating interest rates on the underlying loan agreements by approximately 0.6%.

The Corporation has also entered into currency swap agreements which effectively fix the repayment of the 6.75% Deutsche mark bearer bonds at a principal amount of U.S. \$50.1 million and results in an effective cost of funds of 8.85%.

(v) The total sinking fund requirements and long-term debt due in each of the next five fiscal years are as follows:

|      |                  |      |                  |
|------|------------------|------|------------------|
| 1988 | \$139.7 million; | 1991 | \$303.2 million; |
| 1989 | \$177.8 million; | 1992 | \$383.8 million. |
| 1990 | \$242.9 million; |      |                  |



## 7 Interests Of Minority Shareholders

| (millions)                              | 1987           | 1986           |
|-----------------------------------------|----------------|----------------|
| <b>Preferred equity</b>                 |                |                |
| Polysar Limited                         |                |                |
| Third Preferred                         | \$ -           | \$180.8        |
| Petrosar Limited (a subsidiary) Class A | 240.0          | 240.0          |
| Polysar Holdings Limited (a subsidiary) | 28.3           | 56.7           |
|                                         | 268.3          | 477.5          |
| <b>Common equity</b>                    | 0.6            | 17.8           |
|                                         | <b>\$268.9</b> | <b>\$495.3</b> |

(i) Polysar's Third Preferred Shares bear a cumulative cash or stock dividend equal to the lower of 55% of the average of a Canadian bank's prime rate or 8%, if certain earnings levels are achieved each year, otherwise the dividend is non-cumulative. Redemptions during the year totalled \$42.4 million.

On December 18, 1987 Polysar agreed to redeem the remaining Third Preferred Shares in exchange for obligations to the holders of the Third Preferred Shares. Coincident with the redemption which was finalized in 1988, Polysar placed \$42.0 million in an irrevocable trust to satisfy the above mentioned obligations. Under the terms of the agreements between the parties, Polysar will not be required to make further contributions to the trust in satisfaction of the obligations and as a result the trust assets and corresponding obligations have been removed from the accounts. After writing off related goodwill and providing for taxes on the estimated income of the trust, for the life of the trust, the transactions resulted in non-recurring income of \$5.0 million. Following is a summary of the calculation:

### Third Preferred Share redemption:

|                                            |               |
|--------------------------------------------|---------------|
| 1987 redemption                            | \$ 42.4       |
| February 1988 redemption                   | 138.4         |
|                                            | 180.8         |
| Cash consideration, 1987                   | (42.4)        |
| Cash placed in trust                       | (42.0)        |
|                                            | (84.4)        |
| <b>Adjustments:</b>                        |               |
| Write-off of Goodwill                      | (53.4)        |
| Estimated taxes on trust income (deferred) | (38.0)        |
| <b>Net gain</b>                            | <b>\$ 5.0</b> |

(ii) Petrosar's Class A Redeemable Preference Shares bear a cumulative dividend at an annual rate of 1.35% plus 52% of the average of certain Canadian banks' prime rates. These shares are redeemable in the amount of \$60.0 million in 1989 and \$180.0 million in 1990.

(iii) Polysar Holdings' Redeemable Preferred Shares bear a cumulative dividend of 1.25% plus one-half the prime rate of a Canadian bank. Redemption is required in 1988.

## 8 Capital Stock (note 13)

|                                                                                         |  |  |
|-----------------------------------------------------------------------------------------|--|--|
| (i) Authorized                                                                          |  |  |
| Senior Preferred                                                                        |  |  |
| 20 million shares without par value with stated capital not exceeding \$200.0 million.  |  |  |
| Public Preferred                                                                        |  |  |
| 130 million shares without par value with stated capital not exceeding \$650.0 million. |  |  |
| Preferred                                                                               |  |  |
| 30 million shares without par value with stated capital not exceeding \$150.0 million.  |  |  |
| Common                                                                                  |  |  |
| 200 million shares without par value                                                    |  |  |

### (ii) Issued

| (millions)                                                                         | 1987             | 1986             |
|------------------------------------------------------------------------------------|------------------|------------------|
| <b>Senior Preferred</b>                                                            |                  |                  |
| 4,819,700 (1986, 5,000,000) cumulative, redeemable, retractable shares, 1983 issue | \$ 120.5         | \$ 125.0         |
| <b>Public Preferred</b>                                                            |                  |                  |
| 15,000,000 cumulative, redeemable, convertible voting shares, 1980 issue           | 300.0            | 300.0            |
| 8,320,000 floating rate cumulative, redeemable, exchangeable shares, 1985 issue    | 208.0            | 208.0            |
| <b>Preferred</b>                                                                   |                  |                  |
| Nil (1986, 881,748) cumulative, redeemable, convertible, voting Class B shares     | -                | 88.2             |
|                                                                                    | <b>628.5</b>     | <b>721.2</b>     |
| <b>Common</b>                                                                      |                  |                  |
| 61,572,072 shares (1986, 42,082,500)                                               | <b>586.8</b>     | <b>381.2</b>     |
|                                                                                    | <b>\$1,215.3</b> | <b>\$1,102.4</b> |

The 1983 issue of Senior Preferred Shares carry the right to receive preferred cumulative dividends at an annual rate equal to the greater of Cdn. \$2.35 per share and the Canadian dollar equivalent of U.S. \$1.92 per share based on the prevailing rate of exchange for the United States and Canadian dollar on the record date for the payment of each dividend or if no such record date is set, on the date such dividend should have been paid in accordance with the share conditions. Dividends on these shares are payable in Canadian currency or, at the request of their holders, in U.S. currency. These shares are redeemable at the option of the holder on June 1, 1990 at \$25 plus accrued and unpaid dividends. These shares are redeemable by the Corporation after June 1, 1990. The holders of the 1983 issue of Senior Preferred Shares are not entitled to notice of or to attend or vote at meetings of shareholders. Each 1983 Senior Preferred Share carries one currency purchase warrant which entitles the holder to purchase on June 1, 1990 the sum of U.S. \$20.39 on payment of the sum of Cdn. \$25.00. During the year, 180,300 shares were purchased for cancellation.

During the year, 836,136 (1986, 15) Class B Preferred Shares were converted into 8,361,360 (1986, 150) common shares and the remaining 45,612 (1986, 441,256) were redeemed for \$4.6 million.

The 1980 issue of preferred shares are redeemable at the option of the Corporation at \$20.60 per share reducing by 20¢ per year until October 15, 1990 when they become redeemable at \$20 per share. Each share is entitled to a yearly cumulative dividend of \$1.52 per share. Each 1980 preferred share may be converted at the option of the holder into 1.27 common shares at any time until October 15, 1990. (See note 13: Redemption of 1980 Preferred Shares)

The 1985 issue of preferred shares carry the right to receive preferred cumulative dividends at an annual rate equal to the rate obtained by subtracting 1% from the average prime rate of a Canadian bank and

multiplying the result by 0.55, subject to a minimum rate of 5% and a maximum rate of 7%. The Corporation may redeem the shares at any time for \$25 per share but must redeem them in approximately equal amounts from 1992 through 1998 inclusive. The Corporation, at its option, may exchange all or a portion of the preferred shares for subordinated debentures either of itself or of a subsidiary approved by the shareholders. If such exchange occurs, each 1985 preferred share carries a common share purchase warrant entitling the holder to purchase 0.24 common shares, at \$15.75 per share prior to June 30, 1990, increasing thereafter depending on the common share market value.

(iii) Issued during the year

In 1987, 435,012 Common Shares (1986, 633,919 shares) were issued for an aggregate consideration of \$4.2 million (1986, \$4.7 million) under the Shareholder Dividend Reinvestment and Share Purchase Plans and 141,978 Common Shares were issued for an aggregate consideration of \$1.2 million under the Employee Stock Option Plans.

The Corporation issued 1,875,000 Common Shares for a cash consideration of \$18.7 million on April 15, 1987 in connection with the sale of flow-through tax credits of Canterra, 6,000,000 Common Shares for a cash consideration of \$60.8 million on April 23, 1987 and on September 30, 1987, issued 2,676,225 Common Shares in exchange for the common shares of Canterra held by minority shareholders.

|                                               | 1987                |         | 1986                |         |
|-----------------------------------------------|---------------------|---------|---------------------|---------|
|                                               | Number of<br>Shares |         | Number of<br>Shares |         |
| Opening Common Shares                         | 42,082,500          | \$381.2 | 37,448,431          | \$352.5 |
| Equity issues                                 | 7,875,000           | 79.5    | 4,000,000           | 24.0    |
| Dividend reinvestment and share purchase plan | 435,012             | 4.2     | 633,919             | 4.7     |
| Conversion of Class B Preferred               | 8,361,360           | 83.6    | 150                 | —       |
| Canterra Plan of Arrangement                  | 2,676,225           | 40.2    | —                   | —       |
| Employee Stock Options                        | 141,975             | 1.2     | —                   | —       |
| Costs of issues (net of income tax)           | —                   | (3.1)   | —                   | —       |
| Closing Common Shares                         | 61,572,072          | \$586.8 | 42,082,500          | \$381.2 |

(iv) At December 31, 1987, the Corporation had outstanding options to purchase 2,972,565 Common Shares at exercise prices ranging from \$5.875 to \$15.125 per share, with an average price of \$9.58. In 1987, options to purchase 887,825 Common Shares were granted and 945,036 options were issued to employees and officers of Canterra pursuant to the Plan of Arrangement. These options expire at various dates to August 1997.

(v) Common Shares reserved

At December 31, 1987, Common Shares were reserved for issuance as follows:

|                                                              |            |
|--------------------------------------------------------------|------------|
| Conversion of 1980 issue of preferred shares                 | 19,050,000 |
| Exchange of Canterra subordinated debentures                 | 5,882,353  |
| Dividend reinvestment and share purchase plans               | 338,236    |
| Employee stock option plans                                  | 3,279,486  |
| Purchase warrants attached to 1985 issue of preferred shares | 1,996,800  |
| Issue of flow-through shares                                 | 637,857    |
|                                                              | 31,184,732 |

## 9 Earnings Per Share

### (i) Basic earnings per share

|                               | 1987   | 1986     |
|-------------------------------|--------|----------|
| Income (loss) from operations | \$1.33 | \$(7.73) |
| Net income (loss)             | \$3.39 | \$(9.31) |

Earnings per share are calculated after taking into account the dividends paid on preferred shares using the weighted average number of Common Shares outstanding during the year (1987: 52,573,725, 1986: 37,944,603).

### (ii) Fully diluted earnings per share

|                        | 1987   |
|------------------------|--------|
| Income from operations | \$1.26 |
| Net income             | \$2.64 |

Fully diluted earnings per share are determined on the assumption that all outstanding employee stock options, 1980 Preferred Shares, 1985 Preferred Common Share purchase warrants and Canterra Exchangeable Subordinated Debentures had been converted or exercised at the beginning of the year, or for the Debentures on September 30. Funds derived from the exercise of warrants and options were assumed to have been invested to produce an annual after tax return of 5.4%.

### (iii) Adjusted basic earnings per share

|                        | 1987   |
|------------------------|--------|
| Income from operations | \$1.28 |
| Net income             | \$3.18 |

Adjusted basic earnings per share has been calculated as though the conversion of the Class B Preferred Shares had taken place at the beginning of the year.

### (iv) Pro-Forma earnings per share

|                        | 1987               |                    |
|------------------------|--------------------|--------------------|
|                        | Redemption<br>Case | Conversion<br>Case |
| Basic                  |                    |                    |
| Income from operations | \$1.41             | \$1.29             |
| Net income             | \$3.30             | \$2.71             |
| Fully diluted          |                    |                    |
| Income from operations | \$1.35             | \$1.26             |
| Net income             | \$3.08             | \$2.58             |

Pro-Forma earnings per share reflect either the conversion or redemption of the 1980 Preferreds (see note 13) effective January 1, 1987. Money borrowed to redeem shares is assumed to incur interest expense at an after tax rate of 6%. The exact impact on earnings per share will depend on the number of shares converted or redeemed on March 14, 1988. For purposes of this note, the shares are assumed to be either completely redeemed or completely converted.

Pro-forma earnings per share also reflect the issue of 4.65 million common shares to repurchase 4.576 million 1985 Preferred shares effective January 1, 1987 (see Note 13).

## 10 Income Taxes

The provision for income taxes in the consolidated statement of income reflects an income tax rate which differs from the Canadian corporate tax rate for the following reasons:



| (millions)                                                | 1987      | 1986      |
|-----------------------------------------------------------|-----------|-----------|
| Income (loss) before income taxes                         | \$ 212.7  | \$(307.0) |
| Income tax recovery (provision) at expected rate of 51.0% | \$(108.5) | \$ 156.6  |
| Decrease (increase) in taxes resulting from:              |           |           |
| Non-allowable depletion and depreciation                  | (27.2)    | (28.4)    |
| Write-down of property, plant and equipment               | —         | (64.9)    |
| Non-deductible crown charges net of allowances            | 6.2       | (20.8)    |
| Foreign subsidiaries taxed at different rates             | 41.1      | 42.5      |
| Manufacturing and processing tax credit                   | 7.5       | 1.5       |
| Provincial tax rates different from expected              | —         | (16.2)    |
| Inventory allowance                                       | —         | 0.6       |
| After-tax earnings of equity investments                  | 6.6       | 3.4       |
| Other                                                     | (1.9)     | 6.6       |
| Income tax recovery (provision)                           | \$ (76.2) | \$ 80.9   |
| Current                                                   | \$ (21.1) | \$ (15.9) |
| Deferred                                                  | (55.1)    | 96.8      |
|                                                           | \$ (76.2) | \$ 80.9   |

At December 31, 1987 the Corporation's U.S. operations had losses carried forward for income tax purposes of approximately \$90.0 million, the benefit of which has not been recognized in the consolidated financial statements. These losses are available to reduce future taxable income and expire between 1991 and 2000.

#### 11 Equity in Earnings of Discontinued Operations (note 3)

| (millions)             | 1987   | 1986     |
|------------------------|--------|----------|
| CDC Life Sciences Inc. | \$ 2.9 | \$ 10.8  |
| Mining assets          | 1.9    | (59.7)   |
| Allelix Inc.           | (4.1)  | (3.7)    |
| CDC Data Systems       | —      | (17.1)   |
| Sentrol Systems Ltd.   | —      | (1.2)    |
|                        | \$ 0.7 | \$(70.9) |

#### 12 Non-recurring items (note 3, 7 and 11)

| (millions)                                           | Gross   | Income Tax | Net     | Net     |
|------------------------------------------------------|---------|------------|---------|---------|
| i) Gain on sale of investments                       |         |            |         |         |
| CDC Life Sciences Inc.                               | \$131.9 | \$ (39.2)  | \$ 92.7 | \$ 67.9 |
| Falconbridge Limited                                 | 41.4    | (10.4)     | 31.0    | —       |
| Rainbow Pipe Line Co., Ltd.                          | 17.2    | (4.7)      | 12.5    | —       |
| Bellaplast GmbH                                      | 15.3    | 0.6        | 15.9    | —       |
| Sentrol Systems Ltd.                                 | —       | —          | —       | 8.8     |
| Other                                                | —       | —          | —       | 1.1     |
| ii) Other non-recurring items                        |         |            |         |         |
| Foreign exchange loss on repayment of long-term debt | (10.0)  | (2.8)      | (12.8)  | —       |
| Settlement of Ontario Hydro litigation               | 32.1    | (14.4)     | 17.7    | —       |
| Redemption of Polysar Third Preferred shares         | 43.0    | (38.0)     | 5.0     | —       |
| iii) Provision for decline in value of investments   |         |            |         |         |
| CDC Data Systems                                     | (19.0)  | —          | (19.0)  | (45.9)  |
| Mining assets                                        | (20.0)  | —          | (20.0)  | (21.1)  |
| Allelix Inc.                                         | (10.5)  | 4.2        | (6.3)   | —       |
| Petrochemical                                        | (7.5)   | —          | (7.5)   | —       |
| Other                                                | (2.9)   | 1.2        | (1.7)   | —       |
|                                                      | \$211.0 | \$(103.5)  | \$107.5 | \$ 10.8 |

(iv) On September 18, 1987, the Corporation settled the action by Petrosar Limited against Ontario Hydro to recover damages arising from the breach of a sales agreement for atmospheric residual fuel oil. The terms of the settlement included a cash payment of \$150.0 million, extinguishment of all claims and counter claims and termination of the sales agreement. This resulted in a net gain of \$17.7 million after tax. As a result, the contract has been terminated and all legal action against Ontario Hydro has been terminated.

#### 13 Subsequent Events

##### Latex Division

In December 1987, the Corporation reached an agreement which was formalized on February 19, 1988, to sell the latex assets of Polysar subject to regulatory approval which is to be obtained in 1988. Should the sale be finalized as expected the sale price would be approximately \$500 million and a substantial after-tax gain would result.

##### Restructuring Plan

On February 9, 1988, the Corporation approved a Restructuring Plan which would distribute substantial assets to common shareholders in two distributions. The first distribution consists of a dividend declared February 9, 1988, payable April 29, 1988, of 49% of the common shares of Canterra and \$130.0 million aggregate principal amount of Guaranteed Floating Rate Notes.

The second distribution will consist of an aggregate amount of \$500.0 million Deferred Dividend Preferred Shares and up to \$370.0 million of cash. The cash payment will be reduced by any payments made to redeem 1980 Preferred Shares (see below). The second distribution contemplates shareholder approval for a reduction of capital of the Corporation.

The terms of existing Employee Stock Options will be modified on a basis designed to maintain per share ratios of exercise price to market price and the same aggregate value of the optionee's options as existed prior to the Plan.

In addition, Canterra proposes to call a meeting of the holders of Exchangeable Subordinated Debentures to substitute a conversion feature into common shares of Canterra for the present exchange right into Common Shares of the Corporation. If the amendment is not approved, the ratio for the exchange right of each Debenture will be adjusted pursuant to the anti-dilution provisions.

##### Redemption of 1980 Preferred Shares

On February 10, 1988, the Corporation called for redemption its \$300.0 million of 1980 Convertible Preferred Shares for an aggregate amount of \$309.0 million (a price of \$20.60 per share) plus accrued dividends to March 14, 1988.

##### Common Shares Issued

On February 19, 1988 the Corporation reached an agreement to issue, subject to regulatory approval, 4,650,000 Common Shares in exchange for 4,576,000 1985 Preferred Shares for an aggregate value of \$114.4 million.

In December 1987, the Corporation committed to issue 637,857 Common Shares for cash proceeds of \$8.0 million (\$12.54 per share). The proceeds of this offering will be used to fund Canterra's exploration expenditures.

#### 14 Pensions

The Corporation maintains a number of defined benefit pension plans. These plans provide pensions based on length of service and final average earnings. The present value of its current pension benefits attributed to services rendered to December 31, 1987 and the assets, at market related values, available to provide for these benefits is as follows:

|                          |                 |
|--------------------------|-----------------|
| Pension plan assets      | \$319.9 million |
| Accrued pension benefits | \$281.3 million |

The pension surplus is being recognized as a credit to income on a straight line basis over the expected average service life of the employee group, approximately 16 years.

#### 15 Segmented information

##### (i) Industry segments

The Corporation operates in the energy (oil, gas and sulphur) and petrochemical industries.

| (millions)                                    | 1987      | 1986       |
|-----------------------------------------------|-----------|------------|
| Revenue                                       |           |            |
| Sale of products and services                 |           |            |
| Energy                                        | \$ 386.5  | \$ 532.1   |
| Petrochemical                                 | 2,454.6   | 2,035.1    |
|                                               | 2,841.1   | 2,567.2    |
| Interest and other income                     | 27.4      | 37.5       |
|                                               | \$2,868.5 | \$2,604.7  |
| Segment operating profit (loss)               |           |            |
| Energy                                        | \$ 120.9  | \$ (127.8) |
| Petrochemical                                 | 319.0     | 115.2      |
| Corporate                                     | (2.9)     | (11.8)     |
|                                               | 437.0     | (24.4)     |
| Interest and other income                     | 27.4      | 37.5       |
| Corporate expenses                            | (7.5)     | (5.3)      |
| Interest expense                              | (244.2)   | (314.8)    |
| Income taxes                                  | (76.2)    | 80.9       |
| Minority interest                             | (17.2)    | (10.6)     |
| Equity in earnings of discontinued operations | 0.7       | (70.9)     |
| Non-recurring items                           | 107.5     | 10.8       |
| Net income (loss)                             | \$ 227.5  | \$ (296.8) |
| Identifiable assets                           |           |            |
| Energy                                        | \$2,998.3 | \$3,203.6  |
| Petrochemical                                 | 2,199.3   | 2,322.9    |
| Eliminations                                  | (4.9)     | (23.0)     |
|                                               | 5,192.7   | 5,503.5    |
| Long-term investments                         | 245.1     | 658.8      |
| Corporate assets                              | 8.1       | 79.3       |
| Total assets                                  | \$5,445.9 | \$6,241.6  |
| Additions to property, plant and equipment    |           |            |
| Energy                                        | \$ 36.0   | \$ 108.8   |
| Petrochemical                                 | 70.6      | 84.6       |
| Corporate                                     | 0.2       | 0.2        |
|                                               | \$ 106.8  | \$ 193.6   |
| Depreciation, depletion and amortization      |           |            |
| Energy                                        |           |            |
| Operations                                    | \$ 155.7  | \$ 175.8   |
| Write-down of property, plant and equipment   | -         | 304.7      |
| Petrochemical                                 | 121.4     | 125.6      |
| Corporate                                     | 2.9       | 11.8       |
|                                               | \$ 280.0  | \$ 617.9   |

##### (ii) Geographic Segments

The Corporation considers its three geographic segments to be Canada, the United States, and Europe and the rest of the world. Financial information with respect to these segments is as follows:

| (millions)                            | 1987      | 1986      |
|---------------------------------------|-----------|-----------|
| Revenue                               |           |           |
| Sales of products and services        |           |           |
| Canada                                | \$1,280.4 | \$1,317.9 |
| United States                         | 945.0     | 665.3     |
| Europe and rest of world              | 615.7     | 584.0     |
|                                       | 2,841.1   | 2,567.2   |
| Interest and other income             | 27.4      | 37.5      |
|                                       | \$2,868.5 | \$2,604.7 |
| Transfers between geographic segments |           |           |
| Canada                                | \$ 525.1  | \$ 351.3  |
| United States                         | 49.8      | 37.5      |
| Europe and rest of world              | 36.5      | 17.9      |
| Eliminations                          | (611.4)   | (406.7)   |
|                                       | \$ -      | \$ -      |
| Segment operating profit (loss)       |           |           |
| Canada                                | \$ 268.8  | \$ (87.1) |
| United States                         | 51.9      | (71.3)    |
| Europe and rest of world              | 116.5     | 137.6     |
| Eliminations                          | (0.2)     | (3.6)     |
|                                       | \$ 437.0  | \$ (24.4) |
| Identifiable assets                   |           |           |
| Canada                                | \$4,375.3 | \$4,703.9 |
| United States                         | 447.6     | 491.7     |
| Europe and rest of world              | 377.1     | 314.5     |
| Eliminations                          | (7.3)     | (6.6)     |
|                                       | 5,192.7   | 5,503.5   |
| Long-term investments                 | 245.1     | 658.8     |
| Corporate assets                      | 8.1       | 79.3      |
| Total assets                          | \$5,445.9 | \$6,241.6 |

Transfers between geographic segments are accounted for at prices comparable to open market prices. Canadian operations include export sales in 1987 of \$307.3 million (1986, \$197.8 million).

##### (iii) Research and Development

Research and development expenditures charged to income in 1987 amounted to \$51.3 million (1986, \$46.3 million).



## (iv) Supplementary Information

## (a) Summary of Financial Position

|                                             | Energy           |                  | Petrochemical    |                  | Corporate        |                  | Eliminations       |                    | Consolidated     |                  |
|---------------------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|--------------------|--------------------|------------------|------------------|
| (millions)                                  | 1987             | 1986             | 1987             | 1986             | 1987             | 1986             | 1987               | 1986               | 1987             | 1986             |
| <b>Assets</b>                               |                  |                  |                  |                  |                  |                  |                    |                    |                  |                  |
| Current assets                              | \$ 211.1         | \$ 248.8         | \$ 747.1         | \$ 785.0         | \$ 5.0           | \$ 48.1          | \$ (4.9)           | \$ (23.0)          | \$ 958.3         | \$1,058.9        |
| Long-term investments                       | 67.9             | 74.5             | 29.1             | 47.6             | 1,457.7          | 1,573.2          | (1,309.6)          | (1,036.5)          | 245.1            | 658.8            |
| Property, plant and equipment               | 2,613.7          | 2,690.6          | 1,360.1          | 1,372.0          | 1.7              | 2.4              | 23.2               | —                  | 3,998.7          | 4,065.0          |
| Other assets                                | 150.3            | 264.2            | 92.1             | 165.9            | 1.4              | 28.8             | —                  | —                  | 243.8            | 458.9            |
|                                             | <b>\$3,043.0</b> | <b>\$3,278.1</b> | <b>\$2,228.4</b> | <b>\$2,370.5</b> | <b>\$1,465.8</b> | <b>\$1,652.5</b> | <b>\$(1,291.3)</b> | <b>\$(1,059.5)</b> | <b>\$5,445.9</b> | <b>\$6,241.6</b> |
| <b>Liabilities and Shareholders' Equity</b> |                  |                  |                  |                  |                  |                  |                    |                    |                  |                  |
| Current liabilities                         | \$ 204.0         | \$ 143.1         | \$ 504.7         | \$ 469.8         | \$ 58.7          | \$ 28.5          | \$ (4.9)           | \$ (5.1)           | \$ 762.5         | \$ 636.3         |
| Long-term debt                              | 1,840.5          | 2,294.8          | 774.7            | 902.8            | 81.8             | 625.6            | (72.5)             | (72.5)             | 2,624.5          | 3,750.7          |
| Deferred income taxes                       | 386.1            | 379.3            | 77.6             | (19.4)           | (68.7)           | (106.1)          | 1.0                | 1.0                | 396.0            | 254.8            |
| Minority interest                           | —                | —                | 268.9            | 477.9            | —                | —                | —                  | 17.4               | 268.9            | 495.3            |
|                                             | <b>2,430.6</b>   | <b>2,817.2</b>   | <b>1,625.9</b>   | <b>1,831.1</b>   | <b>71.8</b>      | <b>548.0</b>     | <b>(76.4)</b>      | <b>(59.2)</b>      | <b>4,051.9</b>   | <b>5,137.1</b>   |
| Equity of subsidiaries                      | 612.4            | 460.9            | 602.5            | 539.4            | —                | —                | (1,214.9)          | (1,000.3)          | —                | —                |
| Shareholders' equity                        | —                | —                | —                | —                | 1,394.0          | 1,104.5          | —                  | —                  | 1,394.0          | 1,104.5          |
|                                             | <b>\$3,043.0</b> | <b>\$3,278.1</b> | <b>\$2,228.4</b> | <b>\$2,370.5</b> | <b>\$1,465.8</b> | <b>\$1,652.5</b> | <b>\$(1,291.3)</b> | <b>\$(1,059.5)</b> | <b>\$5,445.9</b> | <b>\$6,241.6</b> |

## (b) Summary of Operations

|                                               | Energy        |                  | Petrochemical   |                | Corporate     |                 | Eliminations  |               | Consolidated    |                   |
|-----------------------------------------------|---------------|------------------|-----------------|----------------|---------------|-----------------|---------------|---------------|-----------------|-------------------|
| (millions)                                    | 1987          | 1986             | 1987            | 1986           | 1987          | 1986            | 1987          | 1986          | 1987            | 1986              |
| Sale of products and services                 | \$435.2       | \$ 532.1         | \$2,454.6       | \$2,035.1      | \$ —          | \$ —            | \$(48.7)      | \$ —          | \$2,841.1       | \$2,567.2         |
| Interest and other income                     | 18.0          | 25.0             | 9.4             | 12.5           | —             | —               | —             | —             | 27.4            | 37.5              |
| Total revenue                                 | <b>453.2</b>  | <b>557.1</b>     | <b>2,464.0</b>  | <b>2,047.6</b> | <b>—</b>      | <b>—</b>        | <b>(48.7)</b> | <b>—</b>      | <b>2,868.5</b>  | <b>2,604.7</b>    |
| Costs and expenses other than the undernoted  | (158.7)       | (179.5)          | (2,014.1)       | (1,794.2)      | (7.5)         | (5.3)           | 48.7          | —             | (2,131.6)       | (1,979.0)         |
| Depreciation, depletion and amortization      | (155.7)       | (179.8)          | (121.4)         | (125.6)        | (2.9)         | (11.8)          | —             | 4.0           | (280.0)         | (313.2)           |
| Write-down of property, plant and equipment   | —             | (378.5)          | —               | —              | —             | —               | —             | 73.8          | —               | (304.7)           |
| Interest expense                              | (151.0)       | (173.5)          | (97.2)          | (110.7)        | 4.0           | (30.6)          | —             | —             | (244.2)         | (314.8)           |
|                                               | <b>(12.2)</b> | <b>(354.2)</b>   | <b>231.3</b>    | <b>17.1</b>    | <b>(6.4)</b>  | <b>(47.7)</b>   | <b>—</b>      | <b>77.8</b>   | <b>212.7</b>    | <b>(307.0)</b>    |
| Income taxes                                  | (1.3)         | 36.2             | (72.6)          | 22.3           | 2.2           | 26.7            | (4.5)         | (4.3)         | (76.2)          | 80.9              |
| Minority interest                             | —             | —                | (17.4)          | (20.8)         | —             | —               | 0.2           | 10.1          | (17.2)          | (10.6)            |
| Income (loss) from operations                 | <b>(13.5)</b> | <b>(318.0)</b>   | <b>141.3</b>    | <b>18.6</b>    | <b>(4.2)</b>  | <b>(21.0)</b>   | <b>(4.3)</b>  | <b>83.6</b>   | <b>119.3</b>    | <b>(236.7)</b>    |
| Equity in earnings of discontinued operations | 1.9           | (59.7)           | —               | —              | (1.2)         | (11.2)          | —             | —             | 0.7             | (70.9)            |
| Non-recurring items                           | 12.5          | —                | 26.1            | —              | 63.9          | 10.8            | 5.0           | —             | 107.5           | 10.8              |
| Net income (loss)                             | <b>\$ 0.9</b> | <b>\$(377.7)</b> | <b>\$ 167.4</b> | <b>\$ 18.6</b> | <b>\$58.5</b> | <b>\$(21.4)</b> | <b>\$ 0.7</b> | <b>\$83.6</b> | <b>\$ 227.5</b> | <b>\$ (296.8)</b> |

*(c) Summary of Changes in Financial Position*

|                                                            | Energy    |           | Petrochemical |           | Corporate |           | Eliminations |         | Consolidated |           |
|------------------------------------------------------------|-----------|-----------|---------------|-----------|-----------|-----------|--------------|---------|--------------|-----------|
| (millions)                                                 | 1987      | 1986      | 1987          | 1986      | 1987      | 1986      | 1987         | 1986    | 1987         | 1986      |
| <i>Operating</i>                                           |           |           |               |           |           |           |              |         |              |           |
| Income (loss) from operations                              | \$ (13.5) | \$(318.0) | \$ 141.3      | \$ 18.6   | \$ (4.2)  | \$(21.0)  | \$ (4.3)     | \$ 83.7 | \$ 119.3     | \$(236.7) |
| Interest expense                                           | 151.0     | 173.5     | 97.2          | 110.7     | (4.0)     | 30.6      | -            | -       | 244.2        | 314.8     |
|                                                            | 137.5     | (144.5)   | 238.5         | 129.3     | (8.2)     | 9.6       | (4.3)        | 83.7    | 363.5        | 78.1      |
| <i>Non-cash items</i>                                      |           |           |               |           |           |           |              |         |              |           |
| Depreciation, depletion and amortization                   | 155.7     | 179.8     | 121.4         | 125.6     | 2.9       | 11.8      | -            | (4.0)   | 280.0        | 313.2     |
| Write-down of property, plant and equipment                | -         | 378.5     | -             | -         | -         | -         | -            | (73.8)  | -            | 304.7     |
| Deferred income taxes                                      | 2.1       | (35.2)    | 50.7          | (39.2)    | (3.4)     | (24.8)    | 4.5          | 4.3     | 53.9         | (94.9)    |
| Equity in earnings                                         | -         | -         | (1.5)         | 2.8       | -         | -         | -            | -       | (1.5)        | 2.8       |
| Minority interest                                          | -         | -         | 17.4          | 20.8      | -         | -         | (0.2)        | (10.2)  | 17.2         | 10.6      |
| Cash flow before financing costs                           | 295.3     | 378.6     | 426.5         | 239.3     | (8.7)     | (3.4)     | -            | -       | 713.1        | 614.5     |
| <i>Financing costs</i>                                     |           |           |               |           |           |           |              |         |              |           |
| Interest expense                                           | 151.0     | 173.5     | 97.2          | 110.7     | (4.0)     | 30.6      | -            | -       | 244.2        | 314.8     |
| Capitalized interest                                       | 14.0      | 14.8      | 0.1           | 1.4       | -         | -         | -            | -       | 14.1         | 16.2      |
| Capitalized overhead costs                                 | 10.1      | 13.9      | -             | -         | -         | -         | -            | -       | 10.1         | 13.9      |
| Dividends on preferred shares                              | -         | -         | 10.4          | 11.1      | 39.0      | 45.9      | -            | -       | 49.4         | 57.0      |
| Dividends to minority shareholders                         | -         | -         | 17.3          | 26.3      | -         | -         | -            | -       | 17.3         | 26.3      |
|                                                            | 175.1     | 202.2     | 125.0         | 149.5     | 35.0      | 76.5      | -            | -       | 335.1        | 428.2     |
| <i>Free cash flow</i>                                      |           |           |               |           |           |           |              |         |              |           |
| Operations                                                 | 120.2     | 176.4     | 301.5         | 89.8      | (43.7)    | (79.9)    | -            | -       | 378.0        | 186.3     |
| Non-recurring items                                        | 17.2      | -         | 143.8         | -         | 135.1     | 92.6      | -            | -       | 296.1        | 92.6      |
|                                                            | 137.4     | 176.4     | 445.3         | 89.8      | 91.4      | 12.7      | -            | -       | 674.1        | 278.9     |
| <i>Equity financing</i>                                    |           |           |               |           |           |           |              |         |              |           |
| Issue of capital stock                                     | -         | -         | -             | -         | 205.6     | 28.7      | -            | -       | 205.6        | 28.7      |
| Reduction of preferred stock                               | -         | -         | -             | -         | (92.7)    | (44.1)    | -            | -       | (92.7)       | (44.1)    |
| Net investment by minority interest                        | 1.7       | -         | (209.1)       | (79.6)    | -         | -         | (17.0)       | -       | (224.4)      | (79.6)    |
|                                                            | 1.7       | -         | (209.1)       | (79.6)    | 112.9     | (15.4)    | (17.0)       | -       | (111.5)      | (95.0)    |
|                                                            | 139.1     | 176.4     | 236.2         | 10.2      | 204.3     | (2.7)     | (17.0)       | -       | 562.6        | 183.9     |
| <i>Investment activities</i>                               |           |           |               |           |           |           |              |         |              |           |
| Additions to property, plant and equipment                 | 36.0      | 108.8     | 70.6          | 84.6      | 0.2       | 0.2       | -            | -       | 106.8        | 193.6     |
| Changes in working capital other than cash                 | 34.5      | (26.5)    | (73.8)        | (95.8)    | (33.5)    | (122.1)   | -            | -       | (72.8)       | (244.4)   |
| Investment in non-consolidated subsidiaries and affiliates | (8.6)     | 21.3      | (12.6)        | 5.3       | (364.1)   | (246.1)   | -            | -       | (385.3)      | (219.5)   |
| Additions to other assets                                  | (93.6)    | 10.7      | 24.1          | 33.2      | 27.6      | 12.9      | (17.0)       | -       | (58.9)       | 56.8      |
|                                                            | (31.7)    | 114.3     | 8.3           | 27.3      | (369.8)   | (355.1)   | (17.0)       | -       | (410.2)      | (213.5)   |
| Cash generated (used) during the year                      | \$ 170.8  | \$ 62.1   | \$ 227.9      | \$ (17.1) | \$ 574.1  | \$ 352.4  | \$ -         | \$ -    | \$ 972.8     | \$ 397.4  |
| <i>Cash (applied to) funded by:</i>                        |           |           |               |           |           |           |              |         |              |           |
| Short-term loans                                           | \$ 81.1   | \$ (70.1) | \$ (5.6)      | \$(133.3) | \$ 39.4   | \$(36.5)  | \$ -         | \$ -    | \$ 114.9     | \$(239.9) |
| Long-term debt                                             | (402.7)   | (27.9)    | (141.2)       | 145.1     | (543.8)   | (274.7)   | -            | -       | (1,087.7)    | (157.5)   |
| Inter-segment transfers                                    | 150.8     | 35.9      | (81.1)        | 5.3       | (69.7)    | (41.2)    | -            | -       | -            | -         |
|                                                            | \$(170.8) | \$ (62.1) | \$(227.9)     | \$ 17.1   | \$(574.1) | \$(352.4) | \$ -         | \$ -    | \$(972.8)    | \$(397.4) |



# **FIVE-YEAR FINANCIAL SUMMARY**

(millions)

| <b>Financial Position</b>                    |                                                            | <b>1987</b>       | <b>1986</b>       | <b>1985</b>       | <b>1984</b>       | <b>1983</b>      |
|----------------------------------------------|------------------------------------------------------------|-------------------|-------------------|-------------------|-------------------|------------------|
| <b>Assets</b>                                | Working capital                                            | <b>\$ 195.8</b>   | <b>\$ 422.6</b>   | <b>\$ 389.7</b>   | <b>\$ 142.4</b>   | <b>\$ 225.3</b>  |
|                                              | Fixed assets (net)                                         | <b>3,998.7</b>    | <b>4,065.0</b>    | <b>4,362.3</b>    | <b>4,222.1</b>    | <b>4,162.5</b>   |
|                                              | Long-term investments                                      | <b>245.1</b>      | <b>658.8</b>      | <b>997.5</b>      | <b>1,447.1</b>    | <b>1,525.1</b>   |
|                                              | Other assets                                               | <b>243.8</b>      | <b>458.9</b>      | <b>514.9</b>      | <b>424.7</b>      | <b>193.5</b>     |
|                                              |                                                            | <b>4,683.4</b>    | <b>5,605.3</b>    | <b>6,264.4</b>    | <b>6,236.3</b>    | <b>6,106.4</b>   |
| <b>Liabilities</b>                           | Long-term debt                                             | <b>2,624.5</b>    | <b>3,750.7</b>    | <b>3,883.3</b>    | <b>4,201.8</b>    | <b>4,127.3</b>   |
|                                              | Deferred income taxes                                      | <b>396.0</b>      | <b>254.8</b>      | <b>314.9</b>      | <b>356.4</b>      | <b>285.5</b>     |
|                                              | Interest of minority shareholders                          | <b>268.9</b>      | <b>495.3</b>      | <b>590.5</b>      | <b>520.6</b>      | <b>549.6</b>     |
|                                              |                                                            | <b>3,289.4</b>    | <b>4,500.8</b>    | <b>4,788.7</b>    | <b>5,078.8</b>    | <b>4,962.4</b>   |
| <b>Shareholders' Equity</b>                  | Preferred equity                                           | <b>628.5</b>      | <b>721.2</b>      | <b>765.3</b>      | <b>557.6</b>      | <b>557.6</b>     |
|                                              | Common equity                                              | <b>765.5</b>      | <b>383.3</b>      | <b>710.4</b>      | <b>599.9</b>      | <b>586.4</b>     |
|                                              |                                                            | <b>\$1,394.0</b>  | <b>\$1,104.5</b>  | <b>\$1,475.7</b>  | <b>\$1,157.5</b>  | <b>\$1,144.0</b> |
| <b>Changes in Financial Position</b>         |                                                            |                   |                   |                   |                   |                  |
| <b>Derived from</b>                          | Cash flow before financing costs                           | <b>\$1,009.2</b>  | <b>\$ 707.1</b>   | <b>\$ 884.9</b>   | <b>\$ 763.0</b>   | <b>\$ 563.6</b>  |
|                                              | Financing costs                                            | <b>335.1</b>      | <b>428.2</b>      | <b>491.1</b>      | <b>540.3</b>      | <b>461.5</b>     |
|                                              | Free cash flow                                             | <b>674.1</b>      | <b>278.9</b>      | <b>393.8</b>      | <b>222.7</b>      | <b>102.1</b>     |
|                                              | Issue (reduction) of capital stock                         | <b>112.9</b>      | <b>(15.4)</b>     | <b>214.0</b>      | <b>5.0</b>        | <b>127.4</b>     |
|                                              |                                                            | <b>787.0</b>      | <b>263.5</b>      | <b>607.8</b>      | <b>227.7</b>      | <b>229.5</b>     |
| <b>Applied to</b>                            | Investment in non-consolidated subsidiaries and affiliates | <b>(385.3)</b>    | <b>(219.5)</b>    | <b>(389.1)</b>    | <b>(76.5)</b>     | <b>163.9</b>     |
|                                              | Capital expenditures                                       | <b>106.8</b>      | <b>193.6</b>      | <b>266.1</b>      | <b>195.2</b>      | <b>327.2</b>     |
|                                              | Other uses of funds                                        | <b>165.5</b>      | <b>136.4</b>      | <b>164.8</b>      | <b>266.4</b>      | <b>(101.8)</b>   |
|                                              | Changes in non-cash working capital                        | <b>(72.8)</b>     | <b>(244.4)</b>    | <b>186.4</b>      | <b>33.0</b>       | <b>(62.0)</b>    |
|                                              |                                                            | <b>(185.8)</b>    | <b>(133.9)</b>    | <b>228.2</b>      | <b>418.1</b>      | <b>327.3</b>     |
| <b>Cash generated (used) during the year</b> |                                                            | <b>\$ 972.8</b>   | <b>\$ 397.4</b>   | <b>\$ 379.6</b>   | <b>\$ (190.4)</b> | <b>\$ (97.8)</b> |
| <b>Cash (applied to) funded by</b>           | Short-term loans                                           | <b>\$ 114.9</b>   | <b>\$ (239.9)</b> | <b>\$ 0.8</b>     | <b>\$ 9.1</b>     | <b>\$ (90.3)</b> |
|                                              | Long-term debt                                             | <b>(1,087.7)</b>  | <b>\$ (157.5)</b> | <b>(380.4)</b>    | <b>181.3</b>      | <b>188.1</b>     |
|                                              |                                                            | <b>\$ (972.8)</b> | <b>\$ (397.4)</b> | <b>\$ (379.6)</b> | <b>\$ 190.4</b>   | <b>\$ 97.8</b>   |

# **FIVE-YEAR FINANCIAL SUMMARY**

(continued)

| <b>Income</b>                                        |                                                     | <b>1987</b>       | <b>1986</b> | <b>1985</b> | <b>1984</b> | <b>1983</b> |
|------------------------------------------------------|-----------------------------------------------------|-------------------|-------------|-------------|-------------|-------------|
| <b>Revenues</b>                                      | Sale of products and services                       | <b>\$2,841.1</b>  | \$2,567.2   | \$2,869.9   | \$2,702.5   | \$2,496.7   |
|                                                      | Interest and other income                           | <b>27.4</b>       | 37.5        | 65.9        | 87.8        | 94.8        |
|                                                      |                                                     | <b>2,868.5</b>    | 2,604.7     | 2,935.8     | 2,790.3     | 2,591.5     |
| <b>Expenses</b>                                      | Cost and expenses before the undernoted             | <b>2,131.6</b>    | 1,979.0     | 2,213.1     | 2,137.3     | 2,073.1     |
|                                                      | Depreciation, depletion and amortization            | <b>280.0</b>      | 313.2       | 280.0       | 243.8       | 203.3       |
|                                                      | Write-down of property, plant and equipment         | <b>—</b>          | 304.7       | —           | —           | —           |
|                                                      | Interest                                            | <b>244.2</b>      | 314.8       | 331.4       | 322.5       | 255.5       |
|                                                      |                                                     | <b>2,655.8</b>    | 2,911.7     | 2,824.5     | 2,703.6     | 2,531.9     |
|                                                      |                                                     |                   |             |             |             |             |
| <b>Income (loss) before the following</b>            |                                                     | <b>212.7</b>      | (307.0)     | 111.3       | 86.7        | 59.6        |
|                                                      | Income taxes                                        | <b>(76.2)</b>     | 80.9        | (35.2)      | (56.6)      | (53.9)      |
|                                                      | Minority interest in income of subsidiary companies | <b>(17.2)</b>     | (10.6)      | (18.3)      | (7.1)       | (7.9)       |
| <b>Income (loss) from operations</b>                 |                                                     | <b>119.3</b>      | (236.7)     | 57.8        | 23.0        | (2.2)       |
|                                                      | Equity in earnings of discontinued operations       | <b>0.7</b>        | (70.9)      | (25.8)      | (16.3)      | (46.5)      |
|                                                      | Non-recurring items                                 | <b>107.5</b>      | 10.8        | 127.2       | 49.5        | —           |
|                                                      |                                                     | <b>227.5</b>      | (296.8)     | 159.2       | 56.2        | (48.7)      |
| <b>Net income (loss)</b>                             |                                                     | <b>227.5</b>      | (296.8)     | 159.2       | 56.2        | (48.7)      |
| <b>Preferred share dividends</b>                     |                                                     | <b>(49.4)</b>     | (57.0)      | (53.1)      | (45.8)      | (40.8)      |
| <b>Net income (loss) applicable to common shares</b> |                                                     | <b>\$ 178.1</b>   | \$ (353.8)  | \$ 106.1    | \$ 10.4     | \$ (89.5)   |
| <b>Statistics</b>                                    |                                                     |                   |             |             |             |             |
| <b>Per common share</b>                              | Net income (loss)                                   | <b>\$ 3.39</b>    | \$ (9.31)   | \$ 2.86     | \$ 0.29     | \$ (2.51)   |
|                                                      | Equity (fully diluted)                              | <b>12.29</b>      | 9.26        | 16.37       | 14.65       | 14.69       |
|                                                      | Free cash flow                                      | <b>12.82</b>      | 7.35        | 10.60       | 6.15        | 2.87        |
|                                                      | Fully diluted free cash flow                        | <b>9.01</b>       | 4.62        | 6.00        | 3.74        | 2.00        |
| <b>Ratios</b>                                        | Return on common equity                             | <b>31.0%</b>      | (64.7%)     | 16.2%       | 1.8%        | (14.2%)     |
|                                                      | Working capital ratio                               | <b>1.3:1</b>      | 1.7:1       | 1.5:1       | 1.2:1       | 1.3:1       |
|                                                      | Debt/equity ratio                                   | <b>2.0:1</b>      | 3.5:1       | 2.7:1       | 3.8:1       | 3.7:1       |
|                                                      | Coupon bearing capital/ Common equity*              | <b>4.9:1</b>      | 13.2:1      | 7.9:1       | 9.5:1       | 9.5:1       |
| <b>Other</b>                                         | Common shares outstanding at year end               | <b>61,572,072</b> | 42,082,500  | 37,448,431  | 36,724,803  | 35,688,366  |

\*The ratio of the aggregate amount of total debt, preferred minority interest and preferred shares to common shareholders' equity.



## CORPORATE INFORMATION

A. John Ellis  
*Honorary Chairman and  
Director Emeritus*  
Vancouver, British Columbia

### Directors

Edward W. Best  
*Partner*  
Foster Research  
Calgary, Alberta

John Bruk  
*Deputy Chairman*  
Trilon Bancorp Inc.  
Vancouver, British Columbia

Donald G. Campbell<sup>(1) (2)</sup>  
*Chairman*  
Maclean-Hunter Limited  
Toronto, Ontario

E. Kendall Cork<sup>(1)</sup>  
*Senior Vice President*  
Noranda Inc.  
Toronto, Ontario

Pierre Côté<sup>(1)</sup>  
*Chairman of the Board*  
Celanese Canada Inc.  
Montreal, Quebec

William A. Dimma  
*Deputy Chairman*  
Royal LePage Limited  
Toronto, Ontario

Paul W. Douglas  
*Chairman and Chief  
Executive Officer*  
The Pittston Company  
Greenwich, Connecticut

Bernard F. Isautier<sup>(1)</sup>  
*President and Chief  
Executive Officer*  
Polysar Energy & Chemical  
Corporation  
Toronto, Ontario

Patrick J. Keenan<sup>(1)</sup>  
*Chairman and Chief  
Executive Officer*  
Keewhit Investments Limited  
Toronto, Ontario

Gaultherus Kraijenhoff  
*President*  
*Supervisory Council*  
Akzo N.V.  
Irnhem, The Netherlands

Bernard Lamarre<sup>(2)</sup>  
*Chairman and Chief  
Executive Officer*  
Lavalin Inc.  
Montreal, Quebec

Donald D. Loughheed  
*Corporate Director*  
Calgary, Alberta

John R. McCaig<sup>(1)</sup>  
*Chairman and Chief  
Executive Officer*  
Trimac Limited  
Calgary, Alberta

J. William E. Mingo<sup>(2)</sup>  
*Partner*  
Stewart, MacKeen & Covert  
Halifax, Nova Scotia

Maurice J. Moreau<sup>(2)</sup>  
*Corporate Director*  
Victoria, British Columbia

John D. Redfern  
*Chairman*  
Lafarge Canada Inc.  
Montreal, Quebec  
and Lafarge Corporation  
Reston, Virginia

William P. Wilder<sup>(1)</sup>  
*Corporate Director*  
Toronto, Ontario

### Officers

Pierre Côté  
*Chairman of the Board*

Patrick J. Keenan  
*Vice Chairman*

John R. McCaig  
*Vice Chairman*

Bernard F. Isautier  
*President and Chief  
Executive Officer*

G. Firman Bentley  
*Group Vice President,  
Basic Petrochemical*

Pierre Choquette  
*Group Vice President,  
Polymer*

John B. Hague  
*Group Vice President,  
Energy*

Claude R. Marchand  
*Senior Vice President and  
Secretary*

Daniel P. Owen  
*Senior Vice President,  
Operations*

Roger E. Brownell  
*Vice President and Treasurer*

Nigel G.D. Gray  
*Vice President and General  
Counsel*

J. Patrick Howe  
*Vice President,  
Corporate Relations*

Frank van de Water  
*Vice President and Controller*

<sup>(1)</sup> Executive Committee

<sup>(2)</sup> Audit Committee

#### *Corporate Office*

The principal office of the Corporation is located at Suite 200, 444 Yonge Street, Toronto, Canada M5B 2H4 (Telephone 416-598-7200).

#### *Inquiries*

The Corporation maintains its own shareholder records and pays all dividends directly. Inquiries regarding change of address, stock transfer, dividends or other shareholder matters should be made to Shareholder Services Department at the corporate office (416-598-7300).

#### *Listing and Transfer Agent*

Common shares (Symbol: PYC) are listed on the Montreal, Toronto and Vancouver exchanges. The 1983 Senior Preferred Shares (Symbol: PYC.PR.D) trade on the Toronto Stock Exchange. The transfer agent for these classes of shares is National Trust Company at its principal offices in Vancouver, Calgary, Winnipeg, Toronto and Montreal, and its agent, Royal Trust Company, at its principal office in Halifax.





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